Money and Freedom

An Application of Natural Laws to the Problem of Money / The Disastrous Economic and Political Consequences of our Unsound Monetary System / A Suggested Remedy

Robert de Fremery

[March 1955]

"Money is perhaps the mightiest engine to which man can lend an intelligent guidance. Unheard, unfelt, unseen, it has the power to so distribute the burdens, gratifications, and opportunities of life, that each individual shall enjoy that share of them to which his merits or good fortune may fairly entitle him; or, contrariwise, to dispense them with so partial a hand, as to violate every principle of justice and perpetuate a succession of social slaveries to the end of time." (Alexander Del Mar, *The Science of Money*, p. 39)

"Yet matters pertaining to money *must* be comprehended if there is to be judicious thinking about causes, controls and consequences of inflationary boom. In fact, were it my habit to indulge in admonitions, I would say that the American people had better find out about money--and quick!" (Bradford B. Smith, Economist, United States Steel Corporation, Speech before the Illinois Manufacturers' Costs Association, April 15, 1947)

TABLE OF CONTENTS

PROLOGUE

> "the American people had better find out about money--and quick!" (Bradford B. Smith, Economist, U.S. Steel Corp., April 14, 1947)

Seven years have gone by since the above warning was given. There are doubtless many complacent people who think it was just a false alarm. But future historians -- who will have the benefit of hindsight -- may say that *the warning came too late*.

Social forces for both good and evil may be likened to gigantic flywheels which, once set in motion, are difficult to stop. And many destructive social forces -- including Communism -- were set in motion long ago by our failure to stabilize money. These evil forces have gained increasing momentum as the years have gone by. And it may well be that even in 1947 it was too late to stop these forces from eventually destroying our civilization.

Seven years have gone by -- and we are that much closer to the edge of destruction. But when man is aware of extreme danger, it is not his nature to lie down without a battle. He steels himself for the final struggle-- always with the hope that somehow, somewhere, he will find the strength, the courage, and above all, the understanding necessary to overcome the evil forces that oppose him.

For it is *understanding*, more than anything else, that we need so desperately. If the evil forces that threaten to engulf us were set in motion and given increasing momentum by the environment resulting from our failure to stabilize money, then our best hope of eventually destroying those evil forces lies in solving the problem of money.

Money is supposed to serve man as a standard of value and a medium of exchange. It is as a standard of value that money is of primary importance in determining the stability of our economic, social, and political institutions. The men who built and maintain the complex market economy that sustains our civilization are totally dependent upon the stability of our standard of value. Our businessmen are engaged in combining various values, in the form of raw materials, labor, and management, for the purpose of producing salable products. But periodically they find that their finished products have less value than the sum of the values used in their production. So production stops.

Naturally we should expect such a thing to be continually happening to a small percentage of our producers, i.e., there will always be a few businessmen who will misjudge the marketability and value of the products they produce. But it is absurd to have a situation periodically recurring in which a large percentage of producers find they have misjudged the market. It is absurd to have recurring periods of what appears to be "overproduction." And although we have been taught that our periodic depressions are inherent in our free economic system, there is ample evidence to prove otherwise. There is ample evidence to prove that the real cause of our troubles is a faulty standard of value and a banking system that debases our standard of value to a far greater extent than the most unscrupulous practices of earlier despots and tyrants. This debasement of our standard of value inevitably causes significant changes in that standard and could well account for what appears to be "overproduction" -- a situation in which a large percentage of producers find the end value of the products they produce to be less than the sum of values used in the production of those products.

The few who understand our monetary system have played it for all that it is worth. They have become enormously wealthy. From whence came their wealth? From the many who do not understand that system. *Where else could it come from?* Man has allowed himself to be systematically exploited by a comparatively small number of his fellow men. And he has nobody but himself to blame -- for it was his own failure to solve the problem of money that made it possible for the exploitation to take place.

It is this ignorance of what causes his troubles that leads to still more troubles. For man instinctively seek justice--justice for himself and for his fellow man. And in his blind struggle to obtain justice, man turns away from the natural laws. He loses faith in the ability of freedom to produce justice. He wrongly blames his troubles on the operation of natural laws *instead of on the unstable money for which he alone is responsible*.

No longer wishing to rely on natural laws, and not realizing the true cause of his troubles, man turns to various "isms"--Fascism, Naziism, Welfarestatism, Communism, and Socialism. He turns to these "isms" in a desperate effort to secure a more just economic system; a more even flow of production; a more just distribution of the products being produced; and a more just provision for those who, by reason of age or other limitations, are unable to take part in further production and whose savings have been destroyed by inflation.

But to the extent that man relies on government rather than upon natural laws, he must give up the freedom and liberty that go along with the operation of natural laws. This he is apparently willing to do. A certain minimum of security and justice means more to man than complete freedom. Man is willing to bargain away his freedom in the hope of getting greater security and justice. But the attainment of security and justice by sacrificing freedom is a delusion; for once a man allows his freedom to be taken away from him, he subjects himself to still more insecurity and injustice. Man can't improve upon the natural laws that govern the production and distribution of wealth. And that man who thinks he can -- lacks humility. Such men -- no matter how well intentioned--always throw a monkey wrench into the machinery of the universe. Their minds are finite after all.

We must not follow such false leaders. For every time we do--every time we allow ourselves to be regulated by the finite mind of one of our fellow men rather than by the natural laws of the universe -- we subject ourselves to still more injustice. Nothing is so destructive of the moral fabric of society -- nothing is so destructive of all that is good in man--as the loss of his individual freedom. When man begins bargaining away his freedom in the hope of getting greater security, he has set the stage for a progressive deterioration of society that will eventually result in its total disintegration.

The endless struggle for justice will continue to be an underlying factor in the rise and fall of civilizations -- in the birth and death of societies dedicated to freedom -- until such time as man solves the problem of money--that device of his own creation which makes his complex civilization possible, but which can, in turn, destroy it.

San Anselmo, Calif. Robert de Fremery, March, 1955

INTRODUCTION, ACKNOWLEDGEMENTS & BIBLIOGRAPHY

Although library shelves are already weighted down with books about money, I have no hesitation in offering one more. Any real student of the subject is fully aware of the controversy that still exists in this field. And if a person feels he can contribute toward a better understanding of this all-important subject, he owes it to himself and his fellow man to make the effort to do so.

Most of the research that led to the writing of this book was motivated primarily by a passionate desire to gain a better understanding of economics. Since 1940, every effort has been made to subject my conclusions to the acid test of discussion and criticism. Early drafts of this book were read and valuable criticism received from Professor Milton Friedman, Univ. of Chicago; Seth Axley, investment analyst; Bradford B. Smith, Economist, U. S. Steel Corp.; W. I. King, Economic Advisor for the Committee for Constitutional Government; Professor Carl Uhr, Univ. of San Francisco; William Daegling, Credit Dept., Anglo California Bank; and, last but by no means least, my late father-in-law, David Atkins, author of *Economics of Freedom, Measurement of Economic Value, and A Dimensional National Economy*.

Were I to pick out any one person to whom I am most indebted, I would select David Atkins. In a period in which skepticism and lack of faith in freedom reigned supreme, it was he who planted a picture in my mind that I shall never forget. "A free economic system using a sound money and a sound system of taxation," he said, "may be likened to a pyramid resting squarely on its base. A government-controlled economic system, on the other hand, may be likened to an inverted pyramid resting precariously on its apex."

Human energy -- in the eyes of my father-in-law--could no more be controlled and regulated over a long period of time than could the cosmic forces that regulate the universe. Any attempt to control or regulate the flow of human energy can only be done by repression. And repression will eventually result in revolution. It is worthwhile, therefore, to study the economics of freedom. Unless we solve the problems of a free society, we are doomed to go the way of all civilizations before us.

In compiling the bibliography below, I have listed only those books that contributed materially to the development of my thinking.

- Aftalion L'Or, Le Monnaie et Leur Valeur
- Adams, Brooks The Law of Civilization and Decay
- Anderson, B. M., Jr. Economics and the Public Welfare
- _____. The Value of Money
- Angell, James W. The Behaviour of Money
- Atkins, David Economics of Freedom
- _____. Measurement of Economic Value
- _____. A Dimensional National Economy
- Beard, Charles A. Rise of American Civilization
- Berkey, W. A. The Money Question
- Blakiston Series: Readings in Monetary Theory
- van der Borght, R. History of Banking in all the Leading Nations (Chapter on Holland only)
- Bradford, F. A. Money and Banking
- Bryan, W. J. The First Battle
- Coulborn, W. A. L. A Discussion of Money
- Currie, Laughlin The Supply and Control of Money in the United States
- Del Mar, A. History of Monetary Systems
- _____. The Science Of Money
- de Lynden, R. A. The Curse of Credit
- Dunkman, W. E. Qualitative Credit Control
- Eccles, Marriner Beckoning Frontiers
- Feavearyear, A. E. The Pound Sterling

- George, Henry Progress and Poverty
- Gide and Rist History of Economic Doctrines
- Groseclose, Elgin Money: The Human Conflict
- von Haberler, G. Prosperity and Depression
- Hart, A. F. Money, Debt and Economic Activity
- Hawtrey, R. G. A Century of Bank Rate
- Hayek, F. A. Prices and Production
- _____. Monetary Nationalism and International Stability
- Hollis, Christopher The Two Nations
- Jevons, W. S. Money and the Mechanism of Exchange
- Lippmann, Walter The Good Society
- McCracken, H. L. Value Theory and Business Cycles
- Mints, Lloyd History of Banking Theory
- von Mises, L. The Theory of Money and Credit
- Phillips, McMannus
- and Nelson Banking and The Business Cycle
- Roberson, D. H. Money
- Scherman, Harry The Promises Men Live By
- Tilden, Freeman A World in Debt
- Voorhis, Jerry Out of Debt--Out of Danger
- Whittlesey, C. R. International Monetary Issues
- Wood, C. S. Heavenly Discourse
- _____. Too Much Government

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER I: Some Basic Economic Theory Concerning Money]

Money made our civilization possible. That does not mean that money is the only thing we are dependent upon. There are many other things without which a highly developed market economy could not exist. But given all those other things, and no money, civilization as we know it could never have developed to its present state.

Without money we would have to barter for all our needs. Think for a moment what this would mean. Instead of working to get money -- a generally acceptable medium of exchange -- with which we could then buy anything, each of us would have to produce something that could be traded directly for the things he desired. A very primitive state of society would be the result. Trading under such circumstances would be very difficult. The mere eking out of an existence would so occupy all our waking hours that no time would be left for the better things of life -- music, art, research, study, and all that makes for progress and the betterment of mankind.

The invention of money, more than any other thing, liberated man from an animal-like existence. As Alexander del Mar says, "The logical outcome of barter is slavery; that of money is freedom." (*The Science of Money*, p. 45). The ancients realized this fact. For them the god of freedom was likewise the god of money. He was called "Liber Pater" and either his name or synonym, his effigy, or his symbols, were stamped upon a large proportion of their mint issues.

No sooner was man freed from the limitations of a barter economy than he discovered that his new freedom and economic well-being was quite dependent upon the stability of the supply of money. Why is this so? Because money is subject to the law of supply and demand -- the same as everything else that enters into exchange. The value of a unit of money is determined by the number of those units (total supply) in relation to the total demand for money, i.e., the number of people trying to get money. And unless the supply of money per capita is kept constant, a change in the value of money occurs. For example, suppose that the supply of money in a country decreases by one-half, population remaining the same. Competition will strike a new balance between dollars and population. The competitive bid of population for this smaller supply of money will make it more difficult to obtain a given amount of money. Each unit of money will become worth just twice as many man-hours of work. And during the period in which the number of dollars was decreasing relative to population, people would have been hoarding these dollars of increasing value rather than spending or investing them in further production. This hoarding -- which fundamentally is nothing but speculation in money -- would have aggravated still further the disproportion between dollars and population.

A decreasing supply of money per capita would also work an injustice on all debtor-creditor relationships. It would get increasingly difficult to obtain money with which to repay debts. Debtors would be placed in an unfair situation because the value of the money they repaid would be steadily increasing. And if it became impossible for some debtors to repay their debts, as inevitably happens if the supply of money decreases relative to population, then the helpless debtors would lose whatever property they had pledged as security for their debts. In ancient times people pledged themselves and their families. So when it became impossible to pay their creditors, these unfortunate people were sold as slaves.

In modern times, most countries do not allow their people to pledge themselves or their families as security for their debts. But we have almost the same evil consequences in spite of that. Today a debtor pledges his home, or business, as security. And a contraction of the per capita supply of money results in a foreclosure. The home, or business, reverts to the creditor. And from then on, a tribute is paid to the new owner for the continued use of the property that was lost through no fault of the debtor. (I say "no fault of the debtor" in the sense that he is the helpless victim of an unstable financial system. Actually, it is his fault -- because he and his fellowman did nothing to stabilize this financial system).

Now consider what happens when the supply of money per capita is doubled rather than halved -- again, population remaining the same. The effect on production and society is equally disastrous. Competition will strike a new balance between dollars and population. The competitive bid of the same number of people for a supply of money that has doubled will make it twice as easy to obtain a dollar as formerly. Each unit of money will be worth just half as much in terms of man-hours of work; and during the period in which the number of dollars was doubling relative to population, people with savings would have begun to engage in speculation in other forms of wealth. Rather than lend any more money for production, they would turn to speculation in a vain attempt to maintain the value of their savings. They would buy goods that have already been produced and hold them for a further rise in price. Such activity, of course, would actually stimulate the rise in prices -- thus drawing still more money away from production and into speculation.

An increasing supply of money per capita would also cause injustice in debtor-creditor relationships. It would get increasingly easy to get money with which to repay debts. Creditors would be placed in an unfair situation because the value of the money paid back to them would be less than the value of the money they had lent. A man who sold his home on a contract of sale, for example, would find that by the time he was paid off, he had lost half the value of his property because of the inflation in the per capita supply of money that had taken place.

Inflation of the per capita supply of money also works an injustice on all those living on fixed incomes. Those receiving pensions, or who live on savings, etc., find that the dollars they have to spend are "cheaper" (in terms of the effort necessary to obtain them) than the dollars they originally saved. Some of their value has been taken away by the simple process of inflating the per capita supply of dollars.

The destruction of the value of money by an inflation of the per capita supply of money is tantamount to an expropriation of wealth. Any government that allows the value of its money to be destroyed by inflation of the per capita supply of money is allowing its citizens to be robbed proportionately.

It should be clear from the foregoing that changes in the supply of money is a factor of great importance in determining the amount of justice and injustice that exists in any highly developed market economy. Indeed, there is much evidence to support the conclusion that significant changes in the supply of money relative to the number of people using that money is one of the basic causes underlying the economic and political convulsions that have rocked this and earlier civilizations.

Many well-known economists of the past and present have suggested that there should be some relation between the supply of money and the number of people using that money. Among them were and are: David Ricardo, Alexander del Mar, Carl Snyder, Chester A. Phillips, Frederick A. Bradford, James Angell, and Bradford B. Smith. But none of these men have, to my knowledge, formulated a definite theory of value to support their suggestions.

Value has always been a nebulous concept among economists. They all agree on the general statements, "value is determined solely in exchange" and "value varies directly as supply and demand." But when it comes to an explanation of the nature of value itself, there is considerable disagreement.

One of the chief functions of money is to serve as a standard of value -- which means that a dollar should always represent the same amount of value. But since there is no general agreement among economists as to what "value" is, they obviously can't agree on how to provide us with an accurate standard of value. One school says a dollar would have constant value if it would exchange for the same general quantity of physical goods -- which, in reverse, can be stated as follows: If the general price level is constant, then the dollar has a constant value. But another school believes the foregoing concept of value is inadequate. They believe that as our technique of production improves, costs -- and hence commodity prices -- should be going down. The theory of value underlying this second school of thought is usually expressed as some form of a 'labor' theory of value. It is obvious, however, that value is independent of the amount of labor or effort expended in production -- because what is produced may not exchange at all. Great pains may be taken in the production of some item that nobody wants, and therefore it will have no value.

In recent years, the gap between these two schools of thought has been closed very satisfactorily by David Atkins (see his *Measurement of Economic Value*). According to Atkins, the value of an object is not determined by the effort expended in producing the object, but rather by the effective effort expended in obtaining the object in exchange. The key to Atkins' theory is contained in the following quotation: "That the apple falls from the tree is of the utmost significance from a dynamic standpoint. From an economic standpoint it is equally significant that man moves toward the apple." (David Atkins, *Measurement of Economic Value*, page iii)

The force of attraction that exists between population and wealth is due to man's desires or wants. We all want food, clothing, and shelter, and whatever else we can obtain in addition to these three basic requirements of life. As a result of our wanting these things, a force of attraction is set up and we expend energy to obtain these things. To the extent that we succeed in getting what we want, we have expended what Atkins calls "effective energy." Value, therefore, is the stream of effective energy resulting from the force of attraction which wealth exerts upon man.

This concept of value being effective energy is consistent with the generally accepted statement that value can be determined only in exchange. Not until wealth is exchanged do we know how much of our energy has been effective.

Since the stream of effective energy we call "value" arises from the force of attraction exerted upon man by wealth, it is logical to say that the total amount of effective energy varies directly as population. In other words, the total value of all wealth in a country is determined by the number of people utilizing that wealth. Man is so constituted, biologically and psychologically, that his valuation of the total wealth he utilizes does not change. If the physical quantity of wealth per capita increases, man values each unit of wealth less. If the physical quantity of wealth per capita decreases, man values each unit of wealth more.

This principle, which may be called the population theory of value or the law of total utility, is the true basis for a correctly formulated law of diminishing utility -- a law that, in substance, has already been generally accepted by most economists. The present law of diminishing utility states that when a man consumes or utilizes successive units of the same thing, he values each unit less than the one before. But obviously this law should not be confined solely to the consumption of successive units of the same thing. A person's valuation of any form of wealth is affected by all the forms of wealth he has available for consumption or utilization. The same toy that is valued very highly by a boy that has few toys will be valued very little by the same boy if he has many toys. And so it is with all of us. The more wealth we have available for consumption, the less we value each unit of wealth.

If we apply the population theory of value -- or law of total utility -- to our monetary problem, we reach the conclusion that the supply of money should vary directly as population. Prices (measurements of value in terms of money) result from the interaction of the supply of money with the quantity of goods and services being exchanged for money. If the total value of all goods and services to be exchanged varies directly as population, then it is clear that the supply of money should likewise vary directly as population. Then a unit of money will always represent a constant amount of value.

The application of the law of supply and demand to money is sometimes referred to as the "quantity theory of money." Many attempts have been made to discredit the quantity theory. But if that theory is correctly stated as merely an application of the law of supply and demand, then it is absurd to deny its validity. There is no hope of making progress in the development of economic theory unless the law of supply and demand is acknowledged as a valid law that applies to all things that are exchanged. Nothing but confusion can result from the idea that the value of money is somehow independent of the law of supply and demand.

It goes without saying, however, that the law of supply and demand must be used intelligently. When we say that the price of beef is determined by supply and demand, we don't mean that the price of beef is determined by the supply of beef that actually exchanges for money, and the supply of money that actually exchanges for beef. That would be a mere truism. Such a limited concept of the law of supply and demand would be of absolutely no value in helping us to understand how economic equilibrium is supposed to be maintained. It is the actual and anticipated total supply of marketable beef in relation to the actual and anticipated total effective demand for beef that determines the price of beef. If the supply of marketable beef is expected to decrease, or if the demand for beef is expected to increase, part of the total supply of marketable beef may be temporarily held off the market to wait for the expected rise in the price of beef. Exactly the same forces are operating to determine the total demand for beef. In each case the actual price of beef is determined by the actions of those in possession of the total supply of marketable beef and those in possession of the total effective demand for beef. The decision to hold some of the beef off the market results in an upward pressure on the price of beef. And the decision by some "beef eaters" to eat pork results in downward pressure on the price of beef.

And so it is with money. The value of money in an absolute sense -- i.e., in terms of effective energy -- is determined by the actual and anticipated total supply of money in relation to the actual or anticipated number of people who normally would be competing for that money. The value of money in terms of goods and services is determined by the actual and anticipated total supply of money and the actual and anticipated total amount of goods and services that are marketable. If there is reason to believe the supply of money may contract, or that a large amount of goods may be "dumped" on the market, a part of the total supply of money may be held off the market in anticipation of a fall in prices. And if there is reason to believe the supply of money may expand significantly, or that the amount of goods and services offered for money may be decreased significantly, then a part of the total demand for money (total amount of goods and services that are marketable) may be held of the market in anticipation of a rise in prices. It is the decisions of those in possession of the total supply of money, and those who normally would be offering goods and services for money, that determines the value of money (in terms of goods and services).

Some "hair-splitting" theorist bent on proving that the law of supply and demand does not apply to money may argue that if it's the decisions of those in possession of the total supply of money that affects the value of money, then it's not the total supply of money that is important. But it should be clear from the foregoing that the decisions are determined by actual or anticipated changes in the supply of everything entering the marketplace (including money). It should also be clear that if the law of supply and demand doesn't apply to money, then it doesn't apply to anything else that enters the marketplace. Once more I wish to point out that there is no hope of making progress in the development of economic theory unless the law of supply and demand is acknowledged as a valid law that applies to all things that are exchanged.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER II: Early History Prior to Use of Paper Money]

It is beyond the scope of this thesis to explain the process which finally resulted in the selection of the precious metals -- and finally gold -- as a standard of value and medium of exchange. However, it should be obvious that the essential attribute of the precious metals for use as money is the stability of their supply. Over any short-term period, this stability of supply would exercise its stabilizing influence on economic conditions. But over a longer period, particularly during the birth and development of a market economy, the number of people participating in the market is likely to increase much faster than the supply of precious metals. In this case the rigidity or inelasticity of the supply of precious metals would have a deflationary effect upon the market, as well as an unjust effect upon debtor-creditor relationships.

The governments of earlier civilizations were fully aware of the lack of relationship between the supply of the precious metals and the constantly increasing number of people using them. To offset this obvious weakness they attempted to manage the currency by periodically reducing the amount of gold or silver in each coin. This made possible a steadily increasing supply of coins as the market developed.

But obviously a standard of value that is "managed" in this fashion could be a very arbitrary standard in the hands of an unscrupulous government. Such a government could easily abuse its power for purely personal reasons, i.e., for private gain. Thus a keen student of monetary history has this to say of one of the greatest states of antiquity:

> "To the fond admirer of Roman civilization, schooled in a reverence for Roman probity and Justice, it will come as a shock to find how impotent the government was to resist the temptation to profit by the nefarious practice of currency debasement. The administration that could fling a highway from the Pillars of Hercules to the Bosphorus, and erect the Colosseum and the temple of the Sun at Baalbek, and formulate the principles of law assembled in the Corpus Juris and Pandects, could nevertheless stoop to plugging silver denarii with iron, and washing copper with gilt, and palming off on its citizens the most thinly disguised counterfeits of honest coin. The practice of currency debasement pervades the history of Roman administration. Hardly had money appeared in the Street of Janus, than began the vicious practice that was to work such havoc in the Empire, and by the tradition it gave to Europe, to multiply the misery, the confusion and the blight of medievalism." (Elgin Groseclose, *Money: The Human Conflict*, pp. 35-36). (Italics added)

Groseclose is here taking the extreme view that all the reductions in the gold and silver content of coins by the Romans was bad. But it is quite probable that much of it was a necessary prerequisite to the rise of the Roman Empire. There were undoubtedly a constantly increasing number of people doing business in the expanding Roman markets. This increasing number of people necessitated a proportionate increase in the supply of money. And since the supply of precious metals could not keep pace with the growth of the Roman markets, some debasement of the coinage in terms of the precious metals was necessary in order to provide for an expansion in the supply of money. Had there not been some debasement or depreciation in terms of the precious metals, there would have been an appreciation in terms of effective energy (value).

In other words, it is necessary to differentiate between a debasement of coins in terms of the precious metals, and a debasement of coins in terms of the amount of value (effective energy) they represent. A standard of value is supposed to represent as nearly as possible a constant amount of value (effective energy). A country's money may be debased in terms of the precious metals without debasing it in terms of value or effective energy. Such debasement should be recognized as being a necessary debasement in terms of the precious metals. On the other hand, any debasement of money that results in its being worth less value (effective energy) should be referred to as an unnecessary debasement.

There is no question that some of the debasement practiced by the Romans was unnecessary. Some of the debasement was undoubtedly done solely for political profit. The reason we know this must have happened is that prices were often very unstable and a large amount of injustice occurred between debtors and creditors.

The following quotation from George Finlay's *History of Greece* shows the effects of this monetary mismanagement in Rome:

> "In reviewing the causes which contributed to the decline of the wealth and the diminution of the population of the Roman Empire, it is necessary to take into account the depreciation of the coinage, which frequently robbed large classes of the industrious citizens of a great part of their wealth, reduced the value of property, produced confusion in legal contracts, and anarchy in prices even in the public markets." (p. 432)

And it was Antoninus Augustus who said: "Money had more to do with the distemper of the Roman Empire than the Huns or the Vandals."

The mistake the Romans made was that they allowed their supply of money to be determined by narrow motives of political profit. In exercising the royal prerogative to furnish their citizens with an adequate supply of money with which to do business, they abused their power. They did not maintain a stable supply of money relative to the number of people using that money.

In an effort to protect themselves from the havoc-wrecking practices of the Romans, the Byzantines went to the other extreme of maintaining a constant amount of gold in their coins for a period of 800 years. They tolerated no change in the standard whatsoever for fear that if any change were allowed, some unscrupulous government would abuse the power. They were so strict that any person found guilty of filing, clipping, or issuing false coin had his hand cut off at the wrist!

Such severe punishment may have prevented a change in the value of money in terms of gold, but obviously it must have resulted in an appreciation in the value of money in terms of effective energy. In other words, under that system a coin would steadily be worth more and more in terms of the amount of effective effort that could be exchanged for it. And that must have had a stultifying effect on the growth of Byzantine commerce.

The problem of maintaining a uniform coinage also plagued England for many centuries. The nature of the problem was stated by Feavearyear as follows:

> "Apparently there were always unscrupulous citizens of the state who clipped, filed, washed, and sweated the good money ... Their activities were continuous from Norman times until the eighteenth century ... It is difficult to believe, and yet it is certainly true, that there were periods when every coin in circulation had been clipped down to little more than one-half its proper weight. Clipping was the most persistent economic problem of all." (A. E. Feavearyear, *The Pound Sterling*, pp. 5-6)

Once again we should distinguish between necessary debasement in terms of the precious metals (necessary in order to keep each coin representing the same amount of value or effective energy), and unnecessary debasement (in which case each coin would exchange for less value than before). Some debasement in terms of the precious metals was necessary as the market economy became more highly developed in England and in other countries.

The competition for gold and silver naturally became more and more acute. So the amount of gold or silver in each coin would have to be reduced in order to prevent an increase in the value of each coin in terms of effective energy.

However, although the clipper may have been unwittingly performing a useful service by helping to bring about a necessary debasement of the coinage, nevertheless it should be clear that his activities were illegal and if carried to excess -- as they were -- could cause an unnecessary debasement and much confusion.

The problem of the clipper was solved by a Frenchman: Pierre Blondeau. He invented a machine for turning out a "milled-edge" coin. This invention made clipping virtually impossible.

France adopted the milled-edge coin readily. But when Blondeau arrived in England, he was up against a different situation. Feavearyear tells what happened as follows:

> "In 1649 Blondeau arrived in London and placed his process before a Parliamentary committee, who reported favourably upon it; but for seven years the Council of State continually delayed their decision regarding its adoption. Meanwhile Blondeau had to face the uncompromising hostility of the moneyers. He published a pamphlet accusing them of making the coins of different weights, some heavy and some light, so that their confederates outside the Mint might take out the heavy ones and share the spoil with them.
>
> "They replied by attempting to have him arrested for counterfeiting when he struck off specimens of his workmanship. At last, in 1656, Thomas Symon, a renowned engraver, prepared some dies for coins with the Protector's head, and these Blondeau was permitted to stamp in the Mint. But Cromwell decided, probably for political reasons, not to issue them, and Blondeau seems to have returned to France in disgust." (A. E. Feavearyear, *The Pound Sterling*, pp. 86-87).

What happened then was a sequence of events that undoubtedly has had a profound influence on the history of the world since that time. The moneyers could see the handwriting on the wall. They knew they could not stave off the adoption of the milled-edge coins much longer. So they worked out a new scheme as follows: Although the milled-edge coins could not be clipped, they weighed more than the clipped coins already in circulation. Therefore if the milled-edge coins were adopted, there was a handsome profit to be made by melting down the heavy coins for export if the restrictions on the export of bullion were lifted and if a "free coinage" act were passed so as to guarantee a continuous supply of new, full-weight coins to go into the melting pot.

Now the profitable scheme outlined above has not, to my knowledge, ever been explained in this way. Perhaps such a scheme was never really thought of. At any rate, the following sequence of events took place shortly after Charles II came into power. The first event was that he sent for Blondeau and gave him the title, "Engineer of the Mint." New, milled-edge coins began being issued in February 1663. Then the Act of 1663 was passed which lifted all restrictions on the export of foreign coin or bullion of gold or silver. And then the Act of 1666 was passed -- opening the mints to the free coinage of the metals for anyone who presented them.

Maybe it wasn't actually planned that way -- but at least that's what happened!

And now the mint was in a most ludicrous position. As fast as it turned out fine new milled-edge coins, these coins would disappear into the melting pots of the goldsmiths. And at the same time as this was happening, some of the highest officials of the mint were surreptitiously engaged in having copies made of the old clipped coins which they issued at a good profit to people who accepted them freely.

Sir Dudley North -- one of the keenest brains observing the situation at the time -- looked upon the free coinage Act of 1666 as "'a perpetual motion found out whereby to melt and coin without ceasing, and so feed goldsmiths and coiners at the public charge.'" (Requoted from A. E. Feavearyear, *The Pound Sterling*, p. 113).

The orthodox view of the passage of the Acts of 1663 and 1666 is that they were the result of an intellectual attack upon the mercantilist theory which defended the advantages of altering the coinage whenever governments deemed it necessary to do so. That's the story most historians give us. But it should be clear that if intellect had been applied to the monetary problem, the power of the government to alter the coinage would have remained intact. The supply of precious metals does not keep pace with the growth of markets; and therefore, governments had to have the power to alter the coinage so as to provide for an increasing supply of money.

Alexander Del Mar expressed this same point of view regarding the passage of these Acts, calling it "the greatest calamity to occur in the whole history of money." He refers to the Act of 1666 as the "Crime of 1666;" and he attributes the passage of the Act primarily to the pressure of the East India Company (the chief exporters of bullion) and to influence put upon Charles by the intermediary of his mistress, Barbara Villiers. According to Elgin Groseclose, one of the finest students of money living today, Del Mar's explanation is "probably nearer the truth." Groseclose says it "certainly accords with our experience in the methods of political bodies, which have always shown themselves more pliant and amenable before the pressure of entrenched interests than of intellectual doctrine." (*Money: The Human Conflict*, p. 156).

Why did Del Mar have such strong feelings about this legislation? Why did he call the free coinage act "The Crime of 1666?" Because it marked the death of any precise control over the supply of money by the government, and the birth of what he calls "Private Coinage." It also marked the beginning of a totally erroneous concept of a standard of value. In Del Mar's words:

> "Private coinage, or, as it is now euphemized, 'free' coinage, namely, the license granted to private individuals to coin the precious metals without limit, or to compel the State to make coins for them and to confer upon such coins the legal functions of money, coupled with license to export and melt down the coins, was unknown to the ancient world. In the great states of antiquity, money was a pillar of the constitution. In the republics of Greece and Rome, it was a social instrument, designed, limited, stamped, issued, and made current by the State, -- in short, invented, owned, and regulated by the State. ....
>
> .... "After the fall of the Roman Empire in 1204, the prerogative of the coinage was exercised for a brief period by the emperors of Germany, but soon afterward fell to the various independent states that rose upon the ruins of the old Empire. In a process commenced by the procureur-general under Philip IV, against the Comte de Nevers, for melting down the coins of the realm, it was held that this was a royal prerogative which belonged to the king alone, and which in case of necessity he might employ, not indeed for his private advantage, but in defense of the State. The prerogative was, however, much more fully and completely laid down by Sir Matthew Hale in the celebrated case of the Mixed Moneys. Its unwilling surrender by the Crown took place under the Stuarts. Events have demonstrated that the Act is wholly inconsistent with the safety of the State, and that it demands revision.
>
> ...."Monometallism and bimetallism both imply that money consists of a metal or metals, and that this is what measures value. The implication is erroneous; the theory is physically impossible. Value is not a thing, nor an attribute of things; it is a relation, a numerical relation, which appears in exchange. Such a relation cannot be accurately measured without the use of numbers, limited by law, and embodied in a set of concrete symbols, suitable for transference from hand to hand. It is this set of symbols which, by metonym, is called money. In the Greek and Roman republics, it was called (with a far more correct apprehension of its character) nomisma and nummus, because the law (nomos) was alone competent to create it. The number of the symbols nay be limited, but rudely; the limit may even -- though equitably it should not -- be left to the chances of conquest of mining discoveries, still, *repeated experiments prove that it is the number of the symbols that definitely measures value, not the quantity or quality or merit of the materials of which they may be composed.* A ready proof that it is the numbers and not material of money which measures value is this: If the sum or integer of the symbols is altered, so will be the expression of value (the price) of all things; whereas the material may be altered, e.g. from gold to silver, or from both to inconvertible paper, without at all affecting the expression of value -- provided that the combined denominations or sum and legal function of the symbols remain unchanged.....
>
> ...."It is out of the confusion created by this practice, it is from the fallacy of mistaking metal (which, apart from numbers, cannot measure value any more accurately than barter can) for money (which, apart from metal, can and does accurately measure value) that all contentions on the subject have arisen; nay, more, this confusion is today imperiling the peace of the world. The

> wheels of Industry are at this moment clogged, and what clogs them chiefly is that gross, that sensual, that materialistic conception which mistakes a piece of metal for the measure of an ideal relation, a measure that resides not at all in the metal, but in the numerical relation of the piece to the set of pieces to which it is legally related, whether of metal, or paper, or both combined." (A. Del Mar, *History of Monetary Systems*, pp. 6-9) (Italics added)

What Del Mar is pointing out is that a given weight of gold or silver is not in any sense a standard of value. Prices (measurements of value in terms of money) are determined by supply and demand, i.e., the total supply of money in relation to the total supply of marketable goods and services. It is the total supply of money, not the material of which a unit of money is composed, that determines prices.

The acceptance of the erroneous idea that a given weight of gold could be used as a standard of value has been the basis of almost all of the bitter debates regarding monetary theory and practice that we have had ever since. It was this erroneous concept of a standard of value that underlay the intellectual battle between John Locke and William Lowndes in 1695. And, as we shall see later, it is this erroneous concept of value that divides our present-day experts on money and banking on the question of a return to gold convertibility.

The reign of Charles II vas indeed packed full of momentous events for the monetary historian. Although Charles II relinquished the government's control of coinage by the Acts of 1663 and 1666, there remained the government's power to influence the supply of paper money, which had been making its appearance in ever-increasing amounts. If the moneyers were to get complete control of the situation, then the government would have to be deprived of all power to control the supply of paper money. How this was accomplished will be explained after we first discuss the evolution of paper money. For with evolution of paper money, a method of banking was evolving that was soon to cause more monetary instability than man had ever experienced before.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER III: Origin of Banking]

Banking originated because there was a need for it. In England it had its origin in the work performed by scriveners, the cash-keepers of the 16th century. A scrivener was essentially a warehouseman of coin. He acted as a cashier for one or more merchants, did their bookkeeping, brought in their receipts, made their payments, and rendered a strict account of all transactions. He acted as a warehouseman, or custodian of funds. It is important that this fact be kept in mind: The first banker acted as a warehouseman or custodian of funds.

During this same period, which was before the activities of clippers had been effectively curtailed, there was much light-weight or "clipped" coin in circulation. Goldsmiths had the lucrative practice of sorting all the coin they could, melting down the heavy coin and exporting it. The goldsmiths soon found that the scriveners' business offered a perfect opportunity for getting hold of more coin to sort. So the goldsmiths started paying the scriveners for the right to sort their coin; and whenever possible, the goldsmiths took over the work of the scriveners and kept the merchants' cash themselves.

These early goldsmith-bankers kept two distinct kinds of accounts. In the first kind, if a merchant deposited a large sum, the goldsmith gave him in return a number of receipts of convenient amount equal in total to the sum deposited. These receipts became known as "cash notes" or "bills" and soon became negotiable.

The other kind of account used from the very commencement was a current account called "running cash." In this case the depositor was given no receipt or cash note of a negotiable nature. Instead, he simply drew a draft or check upon the goldsmith whenever he wished to make a payment. The recipient of the check would either call for the cash or deposit the check into his own account, often with another goldsmith.

After a time most people didn't bother to withdraw the coin represented by a note or check. They would merely deposit the paper money to their account. The tendency under such a system was toward the use of less and less coin and more and more notes and checks. The coin remained safely in the vault, while its owner carried on their business by using titles to it, in the form of notes and checks.

The use of notes and checks was a distinct advance in monetary practice, paper money being more practical to carry around. The use of checks, in particular, increased the safety and facility of making all payments.

But the goldsmiths were not content to serve as warehousemen or custodians of funds. They saw the chance to make some "easy money." They noticed that when they had outstanding claims against them totaling £10,000 -- behind which they had £10,000 in silver to pay on demand if requested -- that it only took about £1,000 to redeem the few notes and checks presented for cash payment. So the goldsmiths -- seeing 90% of their cash reserves lying "idle" in their vaults -- proceeded to make loans of paper money, i.e., claims to coin, that were not backed 100% by coin. They reasoned that if £1,000 silver was all that was required to redeem notes and checks equal to ten times that amount, then £10,000 in silver would enable them to lend a total of £100,000 in notes. They knew they could not make good if called upon to do so; but they took interest on these loans just as if they were loans of actual coin.

Then the goldsmiths refined this unscrupulous practice by making loans without actually putting out very many of their own notes. They did this by creating imaginary deposits on their books in the name of the borrower and against which the borrower could draw checks. These checks, of course, were supposed to be redeemable in coin up to the amount of the loan. Thus, when a man wanted to borrow £1,000, the goldsmith would merely make a bookkeeping entry showing that his deposits had increased by that amount -- when in reality, no actual increase had occurred because no deposit of coin was made. The man who had borrowed from the goldsmith now could draw checks against this "deposit," up to a total of £1,000.

A person unfamiliar with banking may find it a little difficult to understand how goldsmiths could have started issuing notes (false titles to gold) and creating imaginary deposits that were subject to withdrawal without getting into immediate trouble. It would seem as if they would soon have their cash reserves withdrawn and find themselves in a very embarrassing position. What saved the goldsmiths, however, was that few people understood what was going on. And under normal conditions -- as the goldsmiths had observed -- people preferred not to withdraw cash. When people received notes and checks in payment for goods or services, they merely deposited this paper money with their own goldsmiths. As each goldsmith was constantly receiving such paper money as deposits, a situation arose in which the total claims each goldsmith had upon the other goldsmiths tended to be offset or cancelled out by the total claims the other goldsmiths had upon the first goldsmith. Because of the cancelling-out process, very little cash was needed to support a tremendous volume of transactions -- providing, of course, the public's confidence in the goldsmiths was not shaken.

And as each goldsmith received deposits consisting of claims on other goldsmiths, these new deposits became the basis for still further extensions of credit -- which, in turn, resulted in a still further increase in the deposits of all goldsmiths. This process was self-generating, fed upon itself, and was limited only by the goldsmith's prudence -- which obviously left much to be desired.

That marked the beginning of what is called "credit banking" as opposed to "deposit banking." The function of a deposit bank is essentially that of a warehouse. And throughout the remainder of this book, the term "deposit bank" will mean such an institution. A deposit bank accepts deposits of coin, safeguards them, and facilitates the transfer of titles to that coin by means of checking accounts. It is conceivable that a deposit bank might even have a separate savings and loan section that would engage in lending money placed with it for that purpose, i.e., money that was not subject to withdrawal on demand. A deposit banker, in other words, has no effect on the total supply of purchasing power. He does not create imaginary deposits on his books. He does not increase or decrease the circulating medium of exchange. All notes and checks payable by a deposit bank are backed 100% by actual coin.

A credit banker, on the other hand, does increase and decrease the circulating medium of exchange. He creates imaginary deposits on his books and allows his customers to draw checks against them. He is engaged in lending credit rather than actual money. The notes and checks payable by a credit bank are, therefore, not backed 100% by coin.

Credit banking made possible a new form of monetary debasement that has had far more disastrous effects upon society than any previous type of debasement. In this new type of debasement, the gold content of the legal standard of value remained unchanged, but the standard was debased by diluting the medium of exchange with false titles to gold. This debasement should, therefore, have been illegal -- and, in fact, it was illegal when engaged in by the scriveners. But when the goldsmiths took over the scriveners' business, they found this method of debasement so profitable that it was a simple matter to corrupt the government sufficiently to allow for its continuance by the goldsmiths. In other words, what was illegal for the scriveners, was legal for the goldsmiths. The goldsmiths claimed that money left with them was in the nature of a loan and that therefore, they had the right to use it for their own interest and profit.

This new type of debasement was, and still is, carried on to an alarming degree. Whereas debasement by clipping had once proceeded to the point that the average coin in circulation weighed half of what it should weigh, this new system of debasement made it possible to inflate to the extent that each paper dollar was backed by only one-tenth of a gold dollar. Soon this ratio was further reduced by the development of what we call "central banking" -- and still later the ratio was reduced again by the development of what is called "the gold exchange standard."

What these early bankers failed to realize -- and what is still not realized today -- is that there is no fundamental difference between diluting or debasing gold with base metals and diluting it with paper money that is not fully representative of gold. Both practices cause prices to be inflated, i.e., higher than they should be (in terms of the legal standard). And in both cases, inflation is inevitably followed by either deflation or devaluation of the standard or both.

As might be expected, when goldsmiths began issuing notes that were not backed by gold and creating imaginary deposits on their books, they became subject to "runs." Those depositors who knew what was going on, and consequently feared for the safety of their funds, would get panicky and "run on the bank." Failures among these goldsmiths were frequent. The entry in Samuel Pepys' Diary for 12 September, 1664, showed his distrust of them "because of their mortality."

However, in spite of the system's questionable start and the frequent failures which accompanied it, the government -- always an avid borrower -- gave it every encouragement and even came to the rescue of the greatest of the goldsmiths, Backwell by name, when a run developed on his bank in 1665.

The goldsmiths now wanted to make it plain that under no circumstances should the government be allowed to control or influence the supply of paper money. The degree to which they were already getting the cooperation of Charles II is exemplified by the fact that he came to the rescue of Backwell during the panic of 1665. Succeeding events have been pictured clearly by Christopher Hollis in his book *The Two Nations*. Briefly, what happened was that the goldsmiths tried to force Charles II into debt by contriving that Parliament should never vote him a sufficient income. If the King were forced to borrow from the goldsmiths, the result would be the passing of the government's power from either King or Parliament into the hands of the money-lenders.

In an attempt to prevent this from happening, Charles made an experiment with paper money. He paid his debts with negotiable paper orders that were legal tender for the discharge of debts. These paper orders were convertible into gold at a specified future date.

The mistake that Charles made was in issuing paper orders for only large sums of money. The goldsmiths immediately entered the picture by offering their own "promises to pay" in smaller denominations in exchange for Charles' "promises to pay." And by professing their willingness to pay on demand, the goldsmiths were able to buy Charles' "promises to pay" at a heavy discount because they were promises to pay in the future.

The goldsmiths, of course, couldn't have paid on demand had they been asked to do so on any large scale, because their notes were not backed 100% by gold. But they always made a point of persuading their customers that it would be foolish to ask for coin when paper money was so much more convenient to carry around.

As a result of the heavy discount the goldsmiths charged when exchanging their notes for Charles' notes, the public became increasingly reluctant to accept Charles' notes. And in l672 the crisis was reached. The public would no longer accept Charles' notes. Charles, figuring that it was the goldsmiths who were the cause of the trouble, postponed for a year his repayment of his past debts to the goldsmiths. Paper orders held by contractors, suppliers of stores, and servants were still to be redeemed when originally due for payment. It was only the paper orders held by bankers that had their redemption date postponed. Charles did not repudiate his debt to the bankers. He agreed to pay 6% interest until such time as he found it possible to repay the principal.

The news of the King's refusal to pay the goldsmiths immediately made the public suspicious of the goldsmiths' "promises to pay." A panic followed -- with all the attendant suffering that results when promises are broken.

Someone had to be blamed -- and the goldsmiths had no intention of shouldering the blame themselves. They wanted to divert the public's attention from an inquiry into the nature of the unsound banking practices they were engaged in. So full blame for the crisis of 1672 was placed upon the King. The public was led to believe that the King's extravagance was solely responsible for the trouble and that under no circumstances should a monarchy be trusted with the nation's supply of money.

The goldsmiths were playing for high stakes. They were looking toward the future. The country needed an expanding medium of exchange; and the goldsmiths wanted to make sure that they, and not the government, would provide that medium of exchange. If the goldsmiths provided it in the form of their own instruments (notes and checks not fully representative of coin), then they would not only be drawing interest on the circulating medium, but they could control the markets by their power to cause a contraction in the circulating medium (by curtailing loans). England as yet had no central bank. And the long-term objective of the goldsmiths was to make sure that when a central bank was formed, it would be put into private hands rather than government hands. They succeeded.

According to Disraeli, the further development of this evil system of banking in England resulted from the Revolution of 1688. To fully appreciate the significance of his views on this subject, a few words about Holland's earlier experience with this system of banking will be helpful.

This new type of "credit banking" started in Holland about 50 years before it did in England. In Holland the merchants originally left their cash with cashiers, who were the counterparts of the English scriveners. Then the goldsmiths or changers took over the business of cashiers, for the same reason they later took over the scriveners' business in England -- to sort out the coin and melt down the heavy coin for export. And, as in England, they surreptitiously developed the practice of loaning some of the funds that had been entrusted to them. In Holland, however, it was just as illegal for the goldsmith to lend money entrusted to him as it had been for his predecessor, the cashier. The fraudulent operations of these goldsmiths caused so much trouble that Article 37 of the decree of March 21, 1606, "forbade all changers from keeping money or cash for merchants, or to receive money for their account from any person or in any way, directly or indirectly, to make settlements for others." In other words, the cashiers had caused so much trouble by their fraudulent operations that they were all put out of business.

But trade had developed to the point that the legitimate work of a deposit banker -- safeguarding money and facilitating the transfer of claims to money -- had become indispensable to the merchants. Accordingly, the city government established the Amsterdam Wisselbank in 1609. It was the official intention to have a large bank take over the cashing and exchanging formerly done by private persons. The Amsterdam bank was originally a bank of deposit. It was simply a warehouse for coin. Deposits of coin were accepted at their bullion value -- the accounts of the depositors being credited for the amount in lawful money, subject to a proper charge for handling.

The convenience of using representative paper money, the value of which was unquestioned since it was backed guilder for guilder by actual coin, resulted in its widespread use for making all payments in Amsterdam. As the bank was not allowed to lend the deposits, it was obviously not able to pay interest to the depositors.

The plan of the Amsterdam Wisselbank was copied in other towns: Middleburg, Dordrecht, and Rotterdam. Confidence in these banks could only be maintained as long as the public was convinced that for each guilder of the bank's paper money there was a corresponding amount of specie and bullion in the coffers of the bank. Accordingly, the burgomasters and council of Amsterdam were required to take oath annually that the treasure was intact.

But again the same evil arose. The temptation to lend some of the deposited money was too great. The lending operations of the Amsterdam Bank were kept secret from the public for many decades. But in 1789, the truth came out and public confidence in the bank fell rapidly. In November, 1790, the bank was admitted to be insolvent. The government of the City of Amsterdam assumed the debt of the bank and made many attempts to recover the prestige of the institution. These attempts were unsuccessful, and the agony of the Bank was ended by royal decree of December 19, 1819.

We see, therefore, that although Holland had the right answer to the problem of how to control banking, the greed and lack of honor among the managers of her great banks led to their downfall.

Now hear what Disraeli has to say about English history and the revolution of 1688:

> "If the history of England be ever written by one who has the knowledge and the courage, and both qualities are equally requisite for the undertaking, the world would be more astonished than when reading the Roman Annals by Niebuhr. Generally speaking, all the great events have been distorted, most of the important causes concealed, some of the principal characters never appear, and all who figure are so misunderstood and misrepresented that the result is a complete mystification." (*Sybil*, p. 17)

> "If it be a salutary principle in the investigation of historical transactions to be careful in

> discriminating the cause from the pretext, there is scarcely any instance in which the application of this principle is more salutary than in that of the Dutch invasion of 1688. The real cause of this invasion was financial. The Prince of Orange had found that the resources of Holland, however considerable, were inadequate to sustain him in his internecine rivalry with the great sovereign of France. In an authentic conversation which has descended to us, held by William at the Hague with one of the prime abettors of the invasion, the prince did not disguise his motives; he said, 'Nothing but such a constitution as you have in England can have the credit that is necessary to raise such sums as a great war requires.' The prince came, and used our constitution for his purpose: he introduced into England the system of Dutch finance. The principle of that system was to mortgage industry in order to protect property: abstractedly, nothing can be conceived more unjust; its practise in England has been equally injurious.... the system of Dutch finance, pursued (in England) more or less for nearly a century and a half, has ended in the degradation of a fettered and burthened multitude. Nor have the demoralizing consequences of the funding system on the more favoured classes been less decided. *It has made debt a national habit; it has made credit the ruling power, not the exceptional auxiliary, of all transactions;* it has introduced a loose, inexact, haphazard and dishonest spirit in the conduct of both public and private life; a spirit dazzling and yet dastardly; reckless of consequences and yet shrinking from responsibility." (Sybil, pp. 23-24) (Italics added)

What did Disraeli mean when he said that credit had become "the ruling power?" All he meant was that in a world that was totally dependent upon the stability of the supply of money, the system of Dutch finance gave the control of that supply to a handful of private individuals. Those who controlled bank credit were now "the ruling power".

If Disraeli's version of history is correct, it appears that William of Orange felt thwarted because the laws of his native country expressly forbade credit banking. And being a man of action, he took advantage of the more lax laws of England to do there what could not be done legally in his own country. Whether or not Disraeli is correct, it is a matter of record that the Bank of England was established in 1694 with a high percentage of Dutchmen on the Governing Board. My own view of history is that this system of credit banking had become pretty well entrenched in England even before the Revolution of l688. However, I don't doubt but that William of Orange spurred it on.

Groseclose gives an interesting account of the formation of the Bank of England:

> "To finance the war with France, the government accepted a proposal of a bank presented by an obscure Scotch promoter, a man by the name of William Paterson whose antecedents apparently did not bear too close scrutiny. It was this same Paterson whose notorious Darien scheme ruined half of Scotland. His proposal was that, in return for an advance of £1,000,000 to the government, the government should accord to him and his associates £65,000 a year as interest and the costs of management, and, in addition, authority to issue bills which should be legal tender. The proposal to give the bills a legal tender was unacceptable to the government, and the whole idea was repugnant to many of the Lords. The pressing need of money, however, finally overcame the prejudices of the upper body of Parliament, and a charter was granted authorizing the bank to issue notes (without legal tender quality, however), to deal in bullion and commercial bills, and to make advances upon merchandise. It enjoyed, in addition, the privilege of limited liability for its shareholders, the advantage of holding the government deposits, and the power of lending money in excess of deposits by reason of the circulating notes it was allowed to issue against government debt." (Groseclose, *Money: The Human Conflict*, pp. 181-182).

Feavearyear's comments on what the bank did for William III were interesting:

> "... Here was where William III had the advantage of Charles II. Charles' credit in 1672 was utterly bad. His paper orders were payable, not on demand, but eighteen months hence. He could not have issued notes payable on demand even if people would have accepted them, for he had no reserve. William and his Government were themselves in no better position. But the Bank was an institution newly floated in triumph in the face of all opposition. At least half the City of London believed in it. The King's 'pay' was bad; but where his tallies would no longer go he could place with ease the Bank's 'bills,' sealed with the common seal of the corporation, and

> engraved with the figure of Britannia seated upon a bank of money. Thus the King's immediate difficulties were surmounted by an inflation of credit of the simplest order." (Feavearyear, *The Pound Sterling*, pp. 116-117).

Any unbiased person would, I believe, say that Charles' credit position was basically sounder than the Bank's. Charles may not have had any reserve, but he didn't need one. His paper orders were not payable on demand; they were payable 18 months hence. The Bank, on the other hand, issued notes payable on demand without a sufficient reserve to pay them all.

It can be argued that the Bank's credit was sounder than Charles' because the public would accept the Bank's notes but not Charles' paper orders. However, it can be easily demonstrated that the public's confidence in the Bank's credit was misplaced. The Bank had hardly been in existence two years before it was forced to suspend payments -- the first of many such suspensions yet to come. But those interested in the Bank's survival were adept at convincing the public that each suspension was due to some cause other than the Bank's unsound method of doing business.

Before continuing with the history of how this system of banking has survived all these years -- this system that had its origin under such questionable circumstances -- let us pause to analyze it. For in spite of the fact that it has collapsed periodically ever since its origin -- dragging with it the entire economic machinery of production and distribution -- most people still think it is sound.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER IV: Analysis of Credit Banking]

Elgin Groseclose -- former analyst for the Guaranty Trust Company of New York -- is one of the most scholarly critics of the system of credit banking. Of the origin of the system he says:

> "The practice of the goldsmiths, of using deposited funds to their own interest and profit, was essentially unsound, if not actually dishonest and fraudulent. A warehouseman, taking goods deposited with him and devoting them to his own profit, either by use or by loan to another, is guilty of a tort, a conversion of goods for which he is liable in civil, if not in criminal, law. By a casuistry which is now elevated into an economic principle, but which has no defenders outside the realm of banking, a warehouseman who deals in money is subject to a diviner law: the banker is free to use for his private interest and profit the money left in trust. .... He may even go further. He may create fictitious deposits on his books, which shall rank equally and ratably with actual deposits in any division of assets in case of liquidation." (Elgin Groseclose, *Money: The Human Conflict*, pp. 178-179).

There are several arguments that are used to defend this unsound system of banking. One of the main arguments is based on a misuse of the word "surplus." As mentioned in the preceding chapter, the early goldsmith banker had noticed that when he operated honestly, i.e., with 100% reserves behind all outstanding notes and checking accounts, only a small fraction of the coin entrusted to him was ever withdrawn at one time. He therefore called the remainder "surplus" and felt free to lend these "surplus" reserves to whomever he wished. Actually, however, these "surplus reserves" were not surplus. The coin was idle in a physical sense only. Ownership of this coin was changing constantly as titles to it (notes and drafts) were used as a medium of exchange. The coin entrusted to the goldsmith was in constant use by proxy. When a check or draft was given in payment for goods or services, there was no question that the coin in the bank (represented by the check) was being used for the payment. That the coin in the bank was not actually withdrawn does not mean it was unused. The person making the payment and the person receiving payment knew the coin was used. But the goldsmith-banker naively argued that the coin was not used because it was still lying in his vault. On the basis of this weak argument, the goldsmiths called their reserves "idle" or "surplus" and decided to use them for their own purposes.

There is still another way in which the idle or surplus reserves of these early goldsmiths were really very much in use. The goldsmiths had to have 100% reserves behind their notes and checking accounts in order to maintain the complete and lasting confidence of the public. There was a possibility of a panic if the public thought the paper money it was using was not fully backed by coin. And indeed, panics were the very thing that demonstrated the weakness of the system ever since it started. Goldsmiths who engaged in credit banking by issuing notes that were not backed by coin, and by creating imaginary deposits, did so on the assumption that they could eat their cake and have it too, i.e., allow the supply of paper money to exceed the amount of coin, and still maintain the confidence that existed when the supply of paper money did not exceed the amount of coin. Logic was against the system from the start, and all our experience has confirmed that logic.

The following statements by H. L. McCracken give us an historical perspective of the problem and a rather amusing defense of the system:

> "This principle (100% reserves) was resorted to in China in 1309, when after centuries of experience with depreciated bank currencies they desired to get on to a firm basis. It is the principle of all those living today who hold that banking "to be really on the square" should be allowed to issue currency equal only to the amount of bullion displaced. It is the principle back of the idea that ... banks should keep 100% of their deposits on reserve ... It operates on the hypothesis that there is a possibility that all money might be demanded the same day, and therefore, safety requires that all the money remain in the bank. But banking experience has taught us that demand for bank deposits follows the 'Law of Statistical Regularity' and its corollary, the 'Inertia of large numbers,' i.e., the ratio of demand to deposits tends to remain fairly constant. In short, banks are no longer pure depositories, but rather 'Insurance Companies;' and as such they insure customers against all reasonable probabilities, but not the worst possibilities. It is conceivable that all should die of some epidemic in one year, or that a conflagration should wipe out cities by the score, but insurance rates are not pushed to the point sufficient to cover such contingencies. So in banking, it is practically possible that a banker may be called upon to pay all his liabilities in the form of deposits in a single day, which has been literally true in periods of fear, as revealed by 'runs' on the banks. But just as insurance companies do not anticipate pestilence and wholesale conflagration, so do bankers not anticipate wholesale financial calamity." (H. L. McCracken, *Value Theory and Business Cycles*, pp. 62-63)

There were undoubtedly some defenders of credit banking in China and in Holland in 1309 and 1609 respectively who used the same argument as McCracken. The answer to this argument should be obvious. An insurance company, by insuring lives or property, will not cause a "pestilence and wholesale conflagration;" whereas a banking system that allows the supply of paper money to exceed the amount of coin it is supposed to represent, actually causes the loss of confidence that eventually results in "wholesale financial calamity." Both the Chinese and the Dutch realized that confidence will eventually be lost in institutions that give promises, direct or implied, to pay out more money on demand than is available in their vaults. Both the Chinese and Dutch resorted to 100% reserve banking because they recognized the dangers inherent in credit banking. But corruption later set in -- as it so often does -- and even these great people eventually succumbed to the evils of credit banking, along with the rest of the world.

Orthodox banking theorists have never given the factor of "confidence" sufficient consideration. And when they do discuss it, they don't deal with the subject in its entirety. Long treatises have been written to prove the soundness of a system of credit banking; but time and again, "lack of confidence" causes credit banking structures to topple.

Why, then, do our banking theorists persist in telling us that the system is sound, that confidence should not be lost, and that depositors should not fear for the safety of their funds? What is the basis for their reasoning?

Their argument runs as follows:

> "Even though a banker's cash reserves do not equal his total deposits, he has outstanding loans which, when repaid, can be used to pay the depositors in full. Furthermore, the outstanding loans may be secured by mortgages or other collateral; and therefore, if for any reason the loans are not repaid, the banker can foreclose, sell the property, and pay the depositor with the proceeds. So why should a depositor ever lose confidence?"

The answer to the above argument is very simple. Experience has shown that it is usually impossible for the banking system to liquidate in the manner described. Naturally, therefore, depositors continue to lose confidence in their banks.

Why does the banking system have trouble liquidating when "confidence" is lost? Because a general withdrawal of cash reserves causes the bankers to try to strengthen their reserve position. To do this, they curtail any further lending operations so as to decrease the outstanding claims against their meager reserves. The result, of course, is a contraction of bank credit -- the medium of exchange. A contraction of the medium of exchange causes the entire price structure to collapse. And when there is less money circulating, it becomes quite impossible for the banks to collect their outstanding loans. And even though the banks foreclose, they cannot sell the foreclosed property for what it was worth. The same contraction of the medium of exchange which makes the repayment of all the bank loans impossible also decreases the dollar value of the property the banks have obtained by foreclosure.

Even supposing that banks did not curtail their lending operations, we must realize that their outstanding loans could be repaid only with notes or checks drawn on other banks. The banks cannot be repaid in gold, or paper-money-fully-representative-of-gold, because that is not what was borrowed in the first place. Banks had merely created imaginary deposits on their books and allowed the borrowers to draw checks against them.

The argument -- that banks have outstanding loans which will enable them to repay depositors in full -- is actually the basis for one of the strongest arguments against the system. From an ethical point of view, what could be more unjust than a system in which people go into debt when the supply of money is inflated with bank credit, and later find they cannot possibly repay that debt when the supply of money is contracted (by a collapse of bank credit), and consequently lose such property as may have been pledged as security for their loans?

This is the same unethical practice that existed even prior to the use of paper money. In earlier days, the supply of money was periodically expanded and contracted by alternately debasing the coinage (by the use of alloys) and then calling in the debased coins for a recoinage at former weight and fineness. Naturally, debts that were entered into while the supply of money was expanded or inflated with a lot of debased coin became impossible to repay when the supply of money was contracted by a recoinage. Hence Omar Khayyam's comments on "the sorry trade" in the 85th stanza of his famous *Rubaiyat*:

"What! from his helpless Creature be repaid Pure Gold for what he lent us dross-allay'd Sue for a Debt we never did contract And cannot answer. Oh, the sorry trade!"

Omar is merely commenting on the injustice that results when the bankers of his time made loans of debased ("dross-allay'd") gold coins and demanded repayment in pure gold. The banker is undoubtedly suing for a debt that was never contracted. The banker is demanding repayment of something he never parted with. It is a "sorry trade." And it's the same sorry trade that we allow our bankers to engage in today. "Sue for a Debt we never did contract, and cannot answer..." could well be the cry from those who have lived under a credit banking system and have suffered from a foreclosure during a depression. During the upsurge of every so-called "business cycle," our bankers are busily engaged in lending their credit (imaginary money), which is exactly analogous to lending "dross allay'd" gold. This expansion of imaginary money leads to loss of confidence and a deflation. But after a deflation of imaginary money, it becomes impossible for everybody to repay their debts to the banks. The debtors then become the "helpless creatures" who give up their homes and their businesses which they previously pledged as security for their loans. It is an unethical, illogical, and unsound system. And it will wreck whatever country persists in using it.

One very important point needs to be emphasized. We must be careful to distinguish between the legitimate and sound business of lending savings (not credit, i.e., imaginary money) and the unsound business of lending credit. Naturally, every money economy needs the services of lending institutions, such as Savings & Loan Associations. The function of these institutions is to gather in the savings of the community for the purpose of lending those savings to those who wish to borrow them. These institutions lend actual money -- not credit. They do not create purchasing power. They merely transfer existing purchasing power. They let one man borrow another man's savings. The medium of exchange is not inflated or diluted in any way by this operation. They do not cause the supply of paper money (notes and checks) to become unrepresentative of actual coin. They create no imaginary money.

Credit banks, on the other hand, are engaged in lending credit rather than savings. They create new purchasing power. They cause inflation or dilution of the medium of exchange by issuing notes that are not backed 100% by coin, and by creating imaginary deposits against which checks can be drawn. As a result of lending credit rather than savings, credit banks jeopardize the legitimate and sound business of lending savings. Credit banking causes the medium of exchange to expand and contract. The supply of money is altered by addition of imaginary money. And changes in the supply of money make the business of lending savings more hazardous than it otherwise would be.

It is difficult to understand why so few students of economics have recognized the parallel between diluting gold with alloys and diluting it with false titles to gold (bank credit). Norman Angell recognized the parallel:

> "Before the day of paper, kings and governments inflated currency by debasement of coins, reducing the amount of gold or silver therein. Everyone could see why this should reduce the value of the currency. That far understanding could get. But that the value of the coins would fall equally if the number were correspondingly great, whether of sound metal or not, seemed beyond understanding ... Of the two methods of inflation -- by debasement or paper -- paper has proved the more subject to confusion and illusion ... In the case of paper all sorts of curious considerations came in to complicate the simple truth that an increase in the number of claims to a given quantity of wealth must reduce the amount which on settlement each claimant will receive; that the larger the number of units the less each unit will be worth." (Norman Angell, *The Story of Money*, p. 237).

The reason bank credit (notes and checks that are not fully representative of gold) causes prices to be inflated, i.e., higher than they should be, may be explained as follows: Prices, at any time, are a result of the balance existing between the medium of exchange and wealth offered for it. Therefore, prices are in terms of the medium of exchange. And when the medium of exchange does not coincide with the standard of value (which is the case when paper money is not fully representative of gold), prices will not be in terms of the standard of value.

It is important that this point be very clear. If gold is the standard of value, and the medium of exchange consists of debased coins, or notes and checks that are not fully representative of gold, i.e., not backed dollar for dollar by gold, then prices are inflated. By "inflated," I mean that prices are higher than they should be, and would be, had only full-weight gold coins or notes and checks fully representative of gold been used.

Perhaps an analogy will help to prove this point. Suppose you were given a yardstick and told to measure the length of a piece of wood. Then you were given a second yardstick and told to measure the same piece of wood again. Now suppose you get different measurements with each yardstick. Obviously, the only possible explanation for the different measurements is that the yardsticks are different. One yardstick must have been longer than the other. If measurements of the same thing give different results, then you know that different units of measurement have been used.

Now let's switch back to economics. A given volume of trade, when measured by a medium of exchange consisting of gold or paper money fully representative of gold, will give a certain price level. The same volume of trade, when measured by a medium of exchange that is expanded with either debased gold coins, or paper money that is not fully representative of gold (bank credit), will give a higher price level. Since the same thing is being measured in both cases, we know that different units of measurement must have been used.

I have labored over the above point at some length because orthodox banking theorists claim that prices are in terms of gold even though the medium of exchange is diluted with bank credit! But simple logic tells us they are wrong. If a given volume of wealth is measured twice by the same standard of value, the measurements (prices) would come out the same both times. The fact that prices are higher when bank credit is used than they would be without bank credit is clear evidence that prices are not in terms of gold when the medium of exchange is diluted with bank credit.

There are two significant principles of money that can be derived from the foregoing conclusions:

1. The medium of exchange must coincide with the legal standard of value if we wish to have prices in terms of our legal standard of value. (That means credit banking cannot be allowed.)
2. The important dimension of a unit of value is the number of those units that are used in the measuring process, not the material of which they are composed. (In other words, the value of a dollar depends upon the number of dollars in use rather than the material of which they are composed. This is merely an application of the Law of Supply and Demand to Money).

Alexander Del Mar -- probably the greatest authority on the history of money that ever lived -- brought this latter point out very clearly in his book, *The Science of Money*:

> "Price implies precision. It is, or is intended to be, a precise expression of value; and it approaches actual precision in proportion as the whole number is limited and known of the pricing symbols or denominators; because the whole number of such symbols is the only steady, stable, permanent, immovable point from which such precise measure of value can be made." (p. 20)

> "The very essence of a measure of any kind is limitation -- indeed, this is the meaning of the term itself; and the more exact these limits are susceptible of being defined in the law, the more efficacious the measure becomes. This is the case with money. Indeed, the very essence of money is limitation, and such is the origin of the word nomisma. The more exact the limits of the volume of money are defined in the law of each State the more equitable will it become in its operation upon prices and the dealings between man and man." (p. 129)

The wisdom inherent in the foregoing quotations may be easier to grasp if we stop to realize that the important attribute of gold as a standard of value is the stability of the supply of gold. A given number of grains of gold would have been a very poor standard of value if the total supply of gold alternately increased and decreased. As Alexander Del Mar pointed out, the important dimension of a unit of value is the total number of those units. That is why the use of debased coins, or bank credit, can cause such mischief. It causes fluctuations in the total supply of money.

Another easy way to recognize the unsoundness of using bank credit as money is by likening bank credit to a short-sale of gold. Fundamentally, when a banker extends credit, he is short-selling gold; that is, he is promising to deliver (if requested) something he doesn't have in his possession. Continued short-sales of a commodity disturb the true value relationship between it and all other commodities. How absurd, therefore, to allow banks to short-sell gold -- our standard of value! It is most important that our standard of value -- gold -- bear a true value relationship to all other commodities. If we allow gold to be short-sold, then the entire price structure is on an artificially high level. And that is exactly what happens when banks extend credit, i.e., lend imaginary money.

Another proof of the fact that prices are not in terms of gold (when notes and checks are not fully representative of gold) occurs every time a country revalues the precious metal -- as the United States did in 1934. If prices were in terms of gold, and the government suddenly says an ounce of gold is worth 35 dollars instead of 22 dollars, then we should expect the price of everything to jump proportionately. The fact that prices do not jump when gold is revalued means simply that prices were not in terms of gold; they were in terms of the medium of exchange, which was not fully representative of gold.

The full significance of this absurd situation still has not dawned upon us. We still do not seem to realize the absurdity of having a standard of value -- chosen because of its stability of supply -- and then proceeding to measure value with a fluctuating supply of bank credit that is not fully representative of our legal standard.

All our measurements of length and weight are in terms of legal standards. We take great pains to ensure that this condition prevails. Our buildings and bridges would certainly topple if they were built with yardsticks and pound weights that fluctuated. But in the field of economics, we are not so careful. We go merrily on our way, ignoring our legal standard of value, and use instead a fluctuating volume of bank credit. Then we wonder why our economic system collapses periodically!

We are so confused in our economic thinking that the following statement of one of our well-known banking theorists stirs no particular comment:

> "Gold, of course, is a commodity and as such is subject to price fluctuations the same as any other commodity -- wheat, for example."

Imagine the uproar that would be forthcoming if one of our physicists said:

> "A yardstick, of course, has length and, therefore, is subject to changes in length the same as any other object that has length -- a growing boy, for example!"

It should be clear to anybody that if a given weight of gold is our legal standard of value, then the price of gold should not change any more than the length of a yardstick should change. The fact that gold is subject to price fluctuations is clear evidence that gold has been debased by paper money that is not fully representative of gold.

You may feel that it is inconsistent for me to say, "if a given weight of gold is our legal standard of value, then the price of gold should not change," when I emphasized earlier that some debasement of coins in terms of gold was necessary in order to maintain a constant relationship between the amount of money in a country and the number of people using that money. But actually there is no inconsistency here. It is a question of what the legal standard of value is. If the legal standard of value is defined in the law of the land as a specified number of dollars per capita -- as it should be -- and if we wish to have all dollars made of gold, then obviously it is necessary to change the gold content of the dollar -- and hence the price of gold -- in order to maintain the accuracy of the legal standard of value. On the other hand, if we ignore the necessity for maintaining a constant relationship between the number of dollars and the number of people using dollars -- as we have done -- and define our legal standard of value as a specified number of ounces of gold, then we should not change the price of gold. In other words, we should maintain our legal standard of value, whatever that standard may be. If the maintenance of our legal standard of value imposes a hardship on us, then something must be wrong with our standard. In that case, we owe it to ourselves to select a new standard of value.

If we are going to define inflation as the condition of prices resulting from the use of a medium of exchange that is not fully representative of the standard of value, then we should offer some criticism of the orthodox definition of inflation. But such is the confusion in economic terminology that one theorist, not being able to get a satisfactory definition of inflation, said the following:

> "... there is obviously much to be said for abandoning the term inflation altogether, and so dispensing with the need for a definition." (A. Pigou, *Economic Journal*, Dec. 1917, p. 490)

More recently, Walter E. Spahr expressed the same sentiment as follows:

> "Discussions of money would gain much in clarity if the word 'inflation' were dropped from our vocabulary. It is a thoroughly unscientific word." (Walter E. Spahr, *It's Your Money*, p. 26)

The fault is not with the word "inflation." The fault lies with us for not using the word "inflation" properly. Any measurement is "inflated" when it is greater than it should be. And so it is with prices -- our measurements of value. When our standard of value is gold, and prices are in terms of a medium of exchange that is not fully representative of gold, then prices are inflated, i.e., higher than they should be. And a thorough understanding of the cause and nature of inflation is a necessary prerequisite to an understanding of what causes deflations.

Please note that the validity of the arguments given to prohibit the use of bank credit as money in no way depends upon the "quality" of bank credit. Many banking theorists and economists have been led to believe that collapses of bank credit are not inherent in the system but rather are a direct result of "unwise" or "unsound" extensions of bank credit. But the fact is that there is no such thing as a "wise" or "sound" extension of bank credit. There is no "wise" or "sound" way of short-selling or debasing your legal standard of value. There is no "wise" or "sound" way for a banker to create imaginary deposits on his books against which checks can be drawn. There is no "wise" or "sound" way to indulge in an activity that is basically dishonest and fraudulent. We're just kidding ourselves if we think that we will eventually discover a "wise" or "sound" way to do what is basically unwise and unsound.

Let us analyze now the cause-and-effect relationship between inflation and deflation. When bank credit is used, the medium of exchange is not fully representative of gold. Prices are higher than they would have been had only gold (or paper money fully representative of gold) been used. Therefore, gold is actually being undervalued in terms of goods and services. If gold is being undervalued in terms of goods and services, then a difference in value must exist between gold and whatever is circulating in lieu of gold. This is very obvious in the case of inflation that is caused by the circulation of light-weight coins. The heavy coin is worth more than the lighter coin, even though, legally, they are supposed to be the same. Exactly the same situation exists when inflation is caused by the issue of false titles to gold (bank credit). Gold and paper money (notes and checks) are supposed to be of the same value under the orthodox gold standard. But actually gold is of more value than the false titles to gold (paper money). That's why the price of gold -- in terms of paper dollars -- is often higher than the legal price of gold.

If a difference in value exists between the legal standard (gold) and whatever is circulating in lieu of the legal standard (false titles to gold), then Gresham's Law ("Bad money drives out good money") will operate. In the case of inflation caused by the circulation of light-weight coins, the full-weight coins were melted down and exported. In the case of inflation caused by the issue of false titles to gold (bank credit), gold was either exported or hoarded during a panic. A bank panic is a fine example of the operation of Gresham's Law, and is evidence of the difference of value existing between promises-to-pay-gold and the gold itself. A promise to pay gold simply can't be worth as much as the actual gold when the number of promises to pay gold far exceeds the amount of gold. That's just common sense.

When panics occur and banks fail, the true difference in value between the paper money and the gold into which it is supposedly convertible becomes apparent in other ways also. The price of gold (the standard of value) goes up! Imagine having the weight of a pound or the length of a yardstick increase! The fact that the price of gold can go up is proof of the fact that prices are not in terms of gold when the medium of exchange is not fully representative of gold.

The basic cause of deflation is, therefore, inflation. Inflation of the medium of exchange with bank credit causes a discrepancy in value between the medium of exchange and the legal standard of value. It is this discrepancy which causes bank panics and the anticipation of bank panics.

It was easy, in the first years in which credit banking was practiced, to see the cause-and-effect relationship between inflation and deflation. But as people became more and more accustomed to the system and what to expect of it, it became more and more difficult to see this cause-and-effect relationship.

Before going any further, I would like to say a few words about the foregoing theory of the business cycle. The cause of depressions has been a subject of study for so long -- and there has been so much disagreement on this subject -- that it has become fashionable to look pityingly upon anyone who thinks he has found the answer. Typical of such an attitude is the following statement made by a brilliant young economist after reading through my manuscript:

> "Your difficulty is you ascribe 'anticipated changes in ...business conditions' solely to changes in money, and unfortunately, the world is not as simple as this!"

First let me state that although I evolved my own theory of the business cycle, it wasn't long before I found that many other economists had come to substantially the same conclusions -- not only just prior to my discovery (1937) but also throughout the last two hundred years. The theory expressed here is nothing new. But, as so often happens when a discovery is made, the thought processes leading up to that discovery may be slightly different; and therefore, a more airtight case may result. It is my firm conviction that the monetary explanation of the business cycle contained herein is airtight. Granted that the explanation is a simple one, but why make the world any more complicated than it really is? And if the explanation given herein is so simple, then it should be easy to discover a flaw in it. I have yet to find that flaw.

Actually, the theory I have given above is simple only because it has not been elaborated upon. When I say that the basic cause of depressions is a perfectly justified fear of a contraction of credit due to the weakness of a credit banking system, I am dealing with fundamentals. I have not yet explained and described the many ways that this fear acts upon our economic system and poisons it. But it doesn't take much imagination to elaborate upon the theory.

Let us trace now, step by step, the evolution of the so-called "business cycle," which in reality is nothing but a "credit" cycle. As stated above, the cause of the cycle was more easily discernible in the early days of the system. Fear for the safety of deposited funds would cause people to run on a bank. These fears would usually prove to be well founded. The banks did not have cash reserves equal to the outstanding notes and checks that were payable on demand. So when people ran on a bank, the bank would fail. The notes and checks payable by that bank would become worthless -- in other words, part of the medium of exchange would be destroyed. This would cause financial ruin to the men served by that bank. And when one bank failed, other banks in the area would become subject to suspicion. This panicky feeling would spread rapidly

-- and it is understandable that it would.

The damage to trade resulting from such financial disturbances was obvious. But the government of England was apparently determined to protect the system. So naturally businessmen were forced to try and anticipate these financial or credit crises so they could liquidate their debts and curtail investments before the trouble started. A reliable guide for businessmen was changes in bank rate. A raise in the rate of discount by the Bank of England was an indication that the bank's reserves were critically low or were expected to be critically low in the near future. The purpose of raising the rate of discount was two-fold: l) to discourage borrowing, and 2) to attract gold into the country -- thereby increasing reserves. If a higher bank rate did not accomplish its purpose, it was raised still further until it did.

The following quotations from R. G. Hawtrey's *A Century of Bank Rate* -- certainly one of the most authoritative books on the subject -- show the effect of bank rate on business conditions:

> "The original adoption of Bank rate as an instrument of monetary regulation was founded on theoretical reasoning. But the practical application of it evolved in the nineteenth century was empirical. Starting from the postulate that a rise in the rate of discount must be a deterrent on the creation of credit, the Bank raised the rate whenever its reserve seemed insufficient, and went on raising it step by step till the desired effect was produced. When the reserve began to increase, the Bank lowered the rate step by step, and, if the reserve continued to rise, brought it down to the minimum of 2 percent and kept it there." (p. 223)
>
> "The broad conclusion to which an examination of the facts leads us is that the policy followed in the use of Bank rate from 1858 to 1914 continued on the whole to be guided by the principles enunciated in the earlier period. Since the aim of the Bank of England was to keep its banking operations within the limits appropriate to its reserve, the reserve is always the governing factor. Any charge in Bank rate is usually associated in an obvious manner with the state of the reserve, and, even where this is not so, that is because causes were believed to be at work to affect the reserve in the near future, such as the existence of gold in transit." (Ibid, p. 40)
>
> "There is statistical evidence that business became more sensitive to Bank rate after 1873. In the thirty years from l844 to 1873 there were eleven occasions on which Bank rate was raised to or above 6 per cent, their total duration being 200 weeks. In the forty years, 1874 to 1913 there were only eight such occasions with an aggregate duration of fifty-five weeks." (Ibid, p. 61)

In other words, businessmen had learned what to expect from a rise in bank rate. If, when Bank rate rose to 6 per cent, they all expected one another to become reluctant buyers, they would become reluctant buyers, and business would decline without the rate being raised any higher.

So it was that Bank rate came to have a very important effect upon business conditions. Indeed, it was claimed by some people that the "business cycle" was caused by changes in bank rate and that the cycle could be controlled by a judicious raising and lowering of bank rate at the proper time. But that's confusing cause with effect. Changes in bank rate were a result of actual or anticipated changes in the reserve position of the Bank of England. A rise in rate vas a public warning that banks were -- or soon would be -- in a less liquid position. The warning of an impending storm is never the cause of the storm! And a rise in the rate of discount should never be considered as a cause of a deflation.

It should be clear that if the underlying cause of the "business cycle" is a change in the reserve position of the banks, then it would be futile to attempt to control the cycle by merely raising and lowering bank rate. A mere lowering of bank rate, for example, would not encourage businessmen to resume business activity unless an actual deflation of bank credit had occurred -- in which case businessmen would then know that the reserve position of the banks is stronger. The determining factor for businessmen is the reserve position of the banks; and bank rate is a guide they can safely use only in so far as it correctly portrays the reserve position of the banks.

The next step in the evolution of the "business cycle" -- and it was a perfectly natural one -- was that large investors and manufacturers began to anticipate changes in bank rate. Rather than wait for bank rate to go up -- in which case they might get caught in a falling market -- they watched all developments that affected the reserve position of central banks and liquidated whenever they thought trouble was coming. The underlying cause of their liquidating was still the same -- i.e., concern over the reserve position of the banks. If the reserve position of the banks was becoming critical -- and a financial stringency and possible panic was therefore to be expected -- then the only sensible thing to do was to liquidate before it occurred. Naturally, this very action -- when it became general enough -- actually produced the deflation that was feared. But again, it would be wrong to say that it was the cause of the deflation. The underlying cause of the deflation is still the actual or expected trouble with the banking system that, in turn, breeds "loss of confidence." "Loss of confidence" has always been recognized as a most powerful factor in business cycle theory. It has also always been recognized as a most powerful factor in precipitating bank panics. But when it comes to analyzing the whys and wherefores of this periodic loss of confidence, we have persistently refused to see the obvious cause of it.

One friend of mine in the banking field has contended that if it were true that manufacturers began curtailing operations because of a loss of confidence in the banking structure, then all depressions would be started by bank panics. In other words, he is arguing that because manufacturers would curtail operations without actually withdrawing their deposits from the banking system, we have clear evidence that their loss of confidence was not due to the banking system.

That is the sort of argument a banker could be expected to give, because he is not engaged in the production and sale of goods. But it's another story for those who are. Manufacturers not only have to be careful to curtail production when they anticipate financial trouble ahead, but they must also be scrupulously careful not to take any action that would hasten and aggravate the financial trouble they fear. For every dollar that they have deposited in the banks, they have hundreds of dollars tied up in goods already produced. They are far more interested in being able to liquidate their inventory than they are in protecting their bank deposits. If they were foolish enough to withdraw their deposits, they would start a panic that would ruin their chances of liquidating their inventory. So they wisely leave their deposits in the banks, curtail production, and hope that they'll be able to liquidate their inventory before the contraction of credit has gone too far.

Manufacturers are fully aware, of course, that when they start curtailing production because of a fear of a banking collapse, they are setting in motion the deflationary spiral that will gradually gain increasing momentum until finally the country is in a full-scale depression. But that is something that can't be helped. They certainly can't be expected to continue producing, and run the risk of a panic catching them with a full inventory.

Once manufacturers begin curtailing production in anticipation of trouble with the banks, economic conditions begin to deteriorate. The banker then commences to get worried, wondering if the loans he has made will be paid back. He becomes reluctant to make any more long-term loans, because he knows that confidence will not be restored until the reserve position of the banking system is greatly improved. So the contraction of credit sets in with a vengeance. And the banker virtuously relieves himself of all blame for the trouble by saying that manufacturers were obliged to curtail production because they had over-expanded. The manufacturers meekly say nothing, because their prime concern is to be able to liquidate what they have already produced. They don't wish to cause others to lose confidence in the banks.

Obviously, all manufacturers who curtail production are not aware of the weakness of the banking system. The ones who can be expected to be most aware of the weakness are those who have to look the furthest ahead in order to protect themselves. Once a few of these "key industries" show signs of a lack of confidence, the banking system itself will heed the warning. Bankers will then pursue restrictive credit policies because they know the key industries will not regain confidence until after the reserve position of the banking system has been improved by a contraction of bank credit. But it would be a gross error to conclude that therefore the key industries must be under government control in order to insure steady production. What is needed is a sound banking system. Given a sound banking system -- and assuming for the sake of argument that some of the key industries were curtailing production because of a temporary maladjustment -- the bankers would know that the curtailment in this case was not due to any fear of a banking collapse. They would know that the maladjustments in the key industries could be expected to straighten out without a collapse of the entire market. But under a system of credit banking, the bankers know that when the key industries have lost confidence, their confidence will not be restored until after a considerable deflation of credit has occurred, i.e., the reserve position of the banking system has greatly improved.

So far, we have discussed only the national consequences of diluting gold with bank credit. Of equal significance are the international consequences -- both economic and political. The economic consequences will be taken up first. Under the gold standard, international equilibrium was supposed to result from a flow of gold from the country whose imports exceeded its exports to the country whose exports exceeded its imports. When gold left a country, prices were expected to fall gradually and exports would then tend to increase. Likewise, when gold entered a country, prices were expected to rise gradually and exports tend to decrease. Thus a fairly close balance between exports and imports for each country was supposed to be maintained.

Now note what happened when bank credit was used. Prices of each country were no longer in terms of gold -- but rather in terms of an inverted pyramid on top of gold. Consequently, any significant movement of gold between countries would threaten drastic changes in the amount of bank credit, and hence in the price levels of the countries concerned. And a constant movement of gold between countries was assured by the operation of Gresham's Law. Credit causes gold to be undervalued in terms of goods and services. Bad money (credit) drives out good money (gold). Gold is exported or hoarded. The inevitable result of the operation of natural law on the international gold-credit money mechanism is, therefore, constant disequilibrium and instability within each country using gold-credit as money. As a result, the whole theory of the advantages of free trade was undermined. Instead of having international trade based squarely on an international division of labor, we had a large part of trade based on sudden changes in price levels, or re-evaluation of currencies. Suppose, for example, that country "A" either devalues its currency or has falling prices following a period of financial stringency. Country "B" begins to import the cheap goods from "A." The producers in "B" will suddenly find their products priced out of their own domestic market. It should be clear that country "B" will be forced to raise a tariff barrier if it wants to prevent a serious deflation in its own markets. But it should be equally clear that the adoption of a tariff barrier will merely put off the basic adjustment that will have to occur eventually in "B's" price level. In other words, a deflation of gold-credit in one country is bound to have repercussions eventually in other gold-standard countries. Indeed, such repercussions are a necessary prerequisite to the maintenance of international equilibrium under the gold standard.

The point to keep in mind is that these necessary adjustments that take place between countries on a gold standard are more catastrophic when credit is pyramided on gold. International as well as national trade is made more unstable by the use of gold-credit. And a direct result of that instability is the raising of tariff barriers. It should be apparent, therefore, that the gold-credit mechanism is not conducive to the development of free trade -- either national or international. You can't blame producers for wanting protection from the vicious markets that result from a gold-credit system.

Another disastrous result of diluting the medium of exchange with bank credit was the effect on exchange rates. One of the traditional arguments for the gold standard was that it facilitated international trade by stabilizing exchange rates. This would have been partially true if paper money were fully representative of gold. If a dollar bill and a pound note were backed 100% by gold, they would exchange for each other at a fixed rate -- determined by the amount of gold each represented. But when credit was extended by the banks -- and paper money was not fully representative of gold -- then exchange rates between two such paper currencies would vary from time to time -- becoming acute during periods of financial stringency, when countries were forced to stop exchanging paper for gold. The use of bank credit thus prevented countries from enjoying stable exchange rates that would have existed had all paper money been kept fully representative of gold.

Those who understand the gold-credit system have been able to profit from the economic instability and unstable exchange rates caused by pyramiding credit on gold. It is a well-known fact that some of the world's largest fortunes were made by speculation in foreign exchange. Strictly speaking, however, we should not refer to such operations as "speculation," because the very act of engaging in these operations sets forces to work that will make the so-called speculation a sure thing. For example, in explaining some of the reasons why gold moves between countries, Hartley Withers, in his book Money-Changing, says:

> "Moreover, imports of gold have a very stimulating effect on speculative stock markets, because an increase in the amount of gold available means a roughly corresponding increase in the amount of credit that bankers can give, so that when gold is known to be coming speculators know that credit will be cheaper for carrying their commitments, and will come in and buy, with a light heart, stock that they could not possibly pay for, but hope to pawn with their bankers until they can sell it at a higher price. And so unless the loss on the exchange side of the business is too great, it often pays the leaders of a bull campaign to import gold, having first laid in a line of stock, and make their profit by unloading during the fit of exhilaration produced by the news that the gold is on the way.
>
> "Or, again, quite apart from any speculative and spectacular motives behind gold shipments, it

> may pay bankers, in a country where rates for money are ruling high, to import gold at an apparent loss, because of the high rates that they get for the credit that they are thereby enabled to give. They thus, in effect, borrow gold, and recoup themselves by being able to lend, on profitable terms, larger amounts than they borrow, since they can always create credit to larger amounts than that of the gold in their vaults. Sometimes, in fact, in times of pressure banks find themselves obliged to import gold so as to strengthen their position, whatever the loss on exchange may be." (p. 161-162) (Italics added)

What Withers has pointed out is that movements of gold are so productive of changes in speculative markets resulting from changes in credit conditions, that there are some people engaged in moving gold from country to country solely for this reason, i.e., to take advantage of the market changes they know will occur as a result of the gold movements.

Of course we should bear in mind that it isn't the gold standard as such that results in these abuses -- but rather our pyramiding of credit on gold. These disturbances would not occur if all countries had kept their paper money (notes and checks) fully representative of gold.

Let us now consider some of the political consequences of this system of banking. One of the most significant political results of the international gold-credit system was the impetus it gave to various plans for internationalism. The proper functioning of the gold-credit mechanism requires that each country abide by "the rules of the game." The rules are simple enough: Expand credit when gold is flowing in; contract credit when gold is flowing out; and let these expansions and contractions of credit have their full effect upon prices and wages.

However, everybody balks at playing according to the rules. We don't like to have prices and wages rising and falling just because certain individuals are moving gold into or out of our country. Nevertheless, our reluctance to abide by the rules is what causes the gold standard to break down completely. We then have an era of 'pegged' exchanges and controls that stifle the free movement of goods and services between countries. The logical solution to this problem, according to the gold-standardist, is to have closer cooperation between all countries -- closer cooperation on monetary matters, that is -- so that the game is played according to the rules by all participants. A powerful drive toward "internationalism" in one form or another is therefore a logical result of the gold-credit mechanism.

Consider now what happens if one country decides that it would rather not play the game and would prefer to cut itself loose from gold altogether and stabilize its own internal economy once and for ail. From the standpoint of the citizens of that country, that would be a most worthwhile objective. But from the standpoint of those who wish to have their gigantic "confidence game" continued -- and we must, of necessity, include all those sincere people who can comprehend no other way of achieving international equilibrium -- the country that balks and tries to withdraw from the game must be brought into line. The result is constant friction between the countries concerned. More of this later.

Now let us consider some of the internal political consequences of this system of banking. Naturally, those who understood it and were profiting thereby, made every effort to perpetuate the system. That was to be expected. They made full use of the press and the educational system itself to keep the public in ignorance of what was going on. They successfully convinced the public that booms and depressions were caused by a free enterprise system rather than the banking system. They successfully hushed up any man -- or his writings -- that showed the correct cause of the trouble. This does not mean that books condemning credit banking were not published. They were. But they didn't get used as textbooks in schools and universities. So naturally, generation after generation of people grew up in total ignorance of the vicious system they lived under -- wondering why there was so much injustice and why, if they were meant to be free, so much injustice seemed to result from freedom. For a more detailed analysis of the extent to which the history taught in English schools was deliberately distorted, I can highly recommend The Two Nations by Christopher Hollis.

Today, of course, there are no "villains." At least we don't need to worry about them if there are. For the greatest amount of trouble today is caused by the many well-meaning, well-intentioned, and sincere people who have been born and raised, and educated, in such a way that they accept our system of credit banking as a normal, natural, and sound development. They accept our periodic depressions as being signs of "excesses" in business, poor management, or some other pet theory that magnifies out of all proportion some slight weakness that exists in a free enterprise economy. These people look upon the speculator in foreign exchange as a man who helps to maintain equilibrium by anticipating gold movements and thereby bringing about an earlier adjustment. And the man engaged in moving gold is likewise acting because of "unwise" or "unsound" or "excessive" credit extensions in some country. Nobody stops to ask whether there is such a thing as a wise or sound extension of bank credit. And few stop to realize that the activities of the gold speculators -- which are natural and inevitable under this system -- set in motion a host of other economic forces that are literally tearing our society apart at the seams.

In short, our greatest enemy today is our own state of confusion. For example, we have often heard the statement, "Unsound money is the most effective means of destroying economic freedom and substituting a socialistic economy."

That statement, as it stands, is true; but most peoples' conception of a sound monetary system is the very system of gold-credit that has been so disastrous! Most people believe that a system of bank credit convertible into gold on demand is basically sound. In fact, our confusion is so great that we believe we need a system of credit banking!

Let us take up this question of a need for credit banking. We are told that we need it because it makes our money "elastic," i.e., it can expand and contract. Yes, we have seen that! Bank credit gives our money elasticity -- the elasticity characteristic of a rubber band. It stretches out -- and, by so stretching, sets up forces that cause it to snap back. But do we need that type of elasticity? Indeed, do we need any type of elasticity other than the elasticity necessary to match an expanding population?

The quotations below give the orthodox argument for having an elastic money. They were taken from a textbook in economics recently used in one of our large universities:

> "We have already observed that bank credit, in the Anglo-Saxon countries at least, performs the greater part of the medium of exchange function and so constitutes a very important element of the currency system. A peculiar and important function of bank credit is to furnish an element of elasticity to the currency system. ....
>
> "In the absence of an elastic element in the currency, variations in the volume of trade must be met by changes in the price level. Stability of prices is so important that there remains urgent need of an elastic volume of currency. ....
>
> "....without such elastic element in its currency system, the modern community would suffer great inconvenience from alternating periods of scarcity and overabundance of currency." (Elementary Economics, by Fairchild, Furniss, & Buck, pp. 569-70)

Never has there been a more damaging distortion of the truth than that contained in the last quotation above. Even if we did need a system that would expand and contract in accordance with the needs of business -- which we most assuredly do not -- it should be crystal clear that our system of credit banking does not give us that type of elasticity. It does just the opposite. It gives us perverse elasticity. It expands and contracts in such a way as to actually generate the business cycle.

Now it goes without saying that if we use bank credit as money -- as a result of which a collapse of credit and trade eventually occurs -- then we should make provisions for an expansion of money as trade revives. But wouldn't it be more sensible to use a money that can't collapse in the first place?

Another argument for a money that can be expanded when needed is the argument that the supply of gold doesn't keep pace with population and therefore, we need a money that can expand as population increases. That argument is perfectly sound. But if a country needs more money than a 100% gold standard provides, then the country ought to abandon the gold standard and adopt a money that can be expanded as needed.

Instead of abandoning the gold standard, we retained it and inflated the medium of exchange with false titles to gold (credit) -- thereby causing prices to be inflated, i.e., not in terms of our legal standard of value. This course of action resulted in our periodically having a complete collapse of prices.

If more money is needed in a country, the most unsound, dishonest, and fraudulent way to provide for more money is to allow the banking system to create imaginary deposits on its books and lend those imaginary deposits to the community.

As implied in the quotations given above, the argument for "contract-ability" may be stated as follows:

> "Unless the supply of money contracts when business activity declines, the modern community would suffer great inconvenience from overabundance of currency."

Nothing could be further from the truth. If business activity declines, why shouldn't money pile up as unused savings and investment capital, thereby tending to depress the rate of interest and help restore equilibrium? Indeed, how can we ever achieve equilibrium if we prevent this normal corrective force from operating?

Another important point to recognize is that if our money all had an actual physical existence (i.e., no credit were used as money), and if the existence of our money were independent of debt, it would be impossible to contract the supply of money without taking it away from somebody. And even supposing that we could find some justification for taking money away from people, would it not be absurd to choose a period of inactivity and unemployment? Would anybody seriously contend that we should take money away from people during periods of depression on the grounds that a decreased volume of trade can get along with a smaller supply of money? Yet that is, in effect, what our credit banking system does. It causes money to be withdrawn from the system during a deflation. And we defend that practice as being necessary! We are paying a terrible price for our stupidity.

Under a system in which debt (bank credit) is used as money (or a system in which money exists only as a result of a debt), the supply of money contracts during a depression (as debts are liquidated). Such a system is praised by some for its "elasticity" -- but those who understand the system and how it works have coined the phrase "perverse elasticity" to describe it.

It is quite a shock to most people to have a person challenge the necessity for bank credit. We have been raised to believe that bank credit is an essential prerequisite to our modern society. But it is money that is an essential prerequisite to our economy. Bank credit has been essential only to the extent that we were using it as money. We have never provided ourselves with an adequate supply of money, so we had to use bank credit as a substitute. There is nothing inherent in the nature of bank credit that we need. Quite to the contrary, the instability inherent in bank credit is precisely what we don't want. That instability is capable of causing instability to the rest of our economy. If we would provide ourselves with an adequate supply of non-collapsible money, the need for bank credit would not exist.

The argument is sometimes presented that if bank credit is unsound, then the same is true of all credit transactions -- for example, book credit and the credit extended by your local grocer. And to a certain extent that is true. The use of credit in any form disturbs the true equilibrium between supply and demand. Theoretically, total supply and total demand are the same quantities. But the moment trade takes place on credit -- in any of its forms -- supply and demand cease to be the same quantities. The use of credit in any form causes prices to be on a higher level than if all business were done on a cash basis. And even though we stop diluting our money with bank credit, there will still be ripples of economic activity resulting from the use of book credit. But that is no excuse for continuing to have complete collapses of activity resulting from the use of a collapsible money (bank credit).

If we, as individuals, wish to buy and sell things on the installment plan, we should have the right to do so. But nobody should have the right to dilute our medium of exchange with bank credit.

An extension of book credit is risky enough without having it extended in terms of a medium of exchange that is itself only a form of credit!

Some people will argue that bank credit cannot be considered as part of the medium of exchange because it is not readily acceptable. Statistics refute this idea. Checks are so readily acceptable today in the United States that almost 90% of our business is done by check. Not only are checks readily acceptable -- they are more readily acceptable than other forms of money. We prefer to do business by check. The only unfortunate thing today is that checks are not fully representative of our legal standard of value. Consequently we have alternate periods of inflation and deflation.

As might be expected, if fractional reserve banking is as unsound as the foregoing analysis would indicate, it should be quite a problem for the bankers themselves -- or the government -- to know how to control it in the public interest. It is. Ever since the system started 300 years ago, men have grappled with the problem of how to control bank credit -- and it is quite obvious that the answer has not been found. Nor will it ever be found.

Banking theory that assumes credit banking to be sound is full of the most inconsistent and illogical reasoning imaginable. And practically all the inconsistencies develop from the unwarranted assumption that bank panics are not inherent in the system. Although the system has been plagued by panics ever since its origin, banking theorists find it convenient to either overlook them entirely or ascribe them to causes originating outside the system.

There are many different theories of how bank credit should be controlled. But if each theory is subjected to the acid test of reality, it quickly appears in its true light -- a theory devoid of all practicability in a world that experiences bank panics or fear of a banking crisis at fairly regular intervals.

"Well," you might ask, "if credit banking is really as unsound as the foregoing analysis would indicate, why has it survived so long? Doesn't its survival indicate its fitness to survive?" Certainly not. The survival of the system in its infancy was a direct result of collusion between the government and the goldsmiths. As time went on, its continued survival was a result of clever distortion of the truth so that the public was confused. And as still more time passed, we lost sight of the basic cause of our troubles altogether and began confusing many of the symptoms of the disease with the basic cause thereof.

As pointed out by Christopher Hollis:

> "There still lingers among men a vague tradition that the financial world has managed and still manages its affairs with an almost superhuman competence. The whole record of history stands open in refutation of that tradition. But it persists because there is one particular trick that they have learned how to play with a skill that is almost uncanny. *It is the trick, when things go wrong, of leaving somebody else to hold the baby*." (Christopher Hollis, The Two Nations, p. 73) (Italics provided by the author)

And that is, in fact, the only reason the system has survived. Each time it collapses, the blame is carefully laid at somebody else's doorstep.

Let us proceed new with a brief history of the system.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER V: Continuation of English History]

During the last half of the 18th century, credit banks began springing up throughout England. And that marked the commencement of the series of credit crises which continued throughout the nineteenth century: 1763, 1772, 1783, 1793, 1797, 1810, 1815, 1825, l837-39, l847, and 1866.

Following the collapse that occurred in 1797, there was a long period in which the Bank of England did not exchange gold for paper. Too many promises-to-pay and too little gold lay behind those promises. The Banks' notes depreciated as much as thirty percent. The Bullion Committee was appointed in 1810 to make a report on the causes of the high price of bullion. As a result of the discussions which centered around the Bullion Report, there was a widespread acceptance of the principle that the quantity of money in circulation was the chief factor in determining the value of money.

The Currency Theory was developed a little later and was largely derived from a strict and narrow interpretation of the views of the Bullion Committee. A. E. Feavearyear explains the position of those who formulated the Currency Theory as follows:

> "Their cardinal tenet was that, to safeguard the value of the standard, the quantity of paper money and coin in circulation should never be allowed to differ from the amount of money which would circulate if the currency were entirely metallic. In a world in which no credit currency had existed, the precious metals had distributed themselves amongst the nations in the proportions necessary to meet the demands of trade in each locality and keep the value of money at the same level everywhere. Paper money had been invented merely as a cheap substitute for metal, and the cause of the troubles which had followed its use was that from time to time the quantity issued had been greater than the amount of gold displaced. Therefore to regulate a paper currency correctly it must be arranged that whenever gold comes into the country an equal amount of paper goes into circulation, and whenever gold leaves the country an equal amount of paper is withdrawn." (*The Pound Sterling*, p. 244)

Samuel Jones Loyd, banker and member of Parliament, put it as follows:

> "'Whenever the aggregate paper circulation of the country fails to conform to the fluctuation of the bullion, then mismanagement is justly said to occur.'" (Ibid., p. 244)

It would appear from these quotations that England had found the source of her troubles and was going to correct them. It seemed as though they finally realized that the medium of exchange, i.e., the "paper circulation," must be made to coincide with the standard of value. Why, then, wasn't this havoc-wreaking banking system reformed? Feavearyear gives the answer as follows:

> "By the term 'paper circulation' was meant simply the note circulation of the Bank of England and other banks. The terms 'money' and and 'currency,' which were used synonymously, referred to notes and coin only. Loyd and Norman, at any rate, were quite definite upon this point. It was the fluctuation of the quantity of these two taken together which alone affected the value of the pound." (Ibid., p. 245)

Feavearyear gives us a hint of what was happening:

> "There is some reason to believe that the Currency theorists clung to the narrow view of the meaning of currency because *to admit that cheques were money would have destroyed the system of control they had designed*." (Ibid., p. 249) (Italics added)

One is certainly led to agree with Feavearyear when it is realized that the early writers upon paper currency, in the first half of the eighteenth century, drew no distinction between notes and drafts (checks). They grouped them both together as "paper credit" and held that they both drove out and took the place of metallic money. (A. E. Feavearyear, *The Pound Sterling*, pp. 100 and 240)

The ideas of the Currency School were opposed mainly by the leaders of what is generally called the Banking School. This school contended -- and rightly so -- that it was absurd to distinguish between notes and checks. They were both part of the total paper circulation -- and any attempt to stabilize prices by regulating note issues alone was nonsensical. However, the Banking School contended that instead of the quantity of money determining the level of prices, it was the level of prices which determined the quantity of money! This theory is still supported by some people today -- and is a good example of how easy it is to confuse cause and effect. Proponents of this theory lose sight of the fact that money is a standard of value, and price is a measurement of value in terms of money. Measurements of weight, length, or value, are the result of measuring with standards of weight, length, or value. Prices (measurements of value) are, therefore, a result of measuring values with money.

(I have been accused of "oversimplifying" the foregoing argument. Admittedly, the analogy is a very simple one. But the simplicity of the analogy in no way detracts from its validity).

Since the members of the Banking School contended that prices were a cause rather than a result of the quantity of money being used, they did not believe that any attempt should be made to stabilize prices by regulating paper money. They believed paper money regulated itself.

Another attempt to belittle the importance of the quantity of money was the contention that changes in the "velocity" of money (rapidity with which it turns over) were of more importance than changes in the quantity of money. This was another example of unsound reasoning. It was only natural that the business and investment world held on to their money when they expected a panic. This caused a decrease in the "velocity" of money. Money was not used. And when a period of financial stringency was over, money naturally came out of hoarding and went to work again. They spoke of this as an increase in its "velocity." But it should be obvious that these changes in the velocity of money were not the basic cause of changes in business conditions. They were the result of actual or anticipated changes in the supply of money.

With the two opposing schools of thought, the Currency School and the Banking School, the banking system was not in any danger. If the Currency School won, the banks would go on extending credit by creating deposits. If the Banking School won, the banks could continue extending credit by the use of both notes and deposits. The public would lose in either case -- and the basic weakness in the system would continue to have its disastrous effects upon the economic system.

The ideas of the Currency School prevailed; and finally, in 1844, the Bank Charter Act was passed, sponsored by Sir Robert Peel. The purpose of the act was to make the English note issue practically synonymous with gold. However, to have adopted the strict theory in 1844, the Bank of England would have had to double its stock of gold. So it was therefore determined that there should be a fixed fiduciary issue of £14,000,000. All notes above this amount would be issued in exchange for, and covered by, their face value of gold coin, gold or silver bullion. The right of the banks to create deposits against which checks could be drawn remained unregulated!

Naturally the gold standard, chosen because of the stability of the gold supply, could be just as easily inflated by creating imaginary deposits as by issuing notes that were not backed one hundred per cent by gold. It was. Crises continued as usual -- 1847, l857, 1866. Charles A. Conant explains what happened as follows:

> "It was the theory of the supporters of the act, that the currency would fluctuate in exact accordance with the fluctuations of a metallic currency by the self-acting provision for the issue of notes only in exchange for gold and the issue of gold in exchange for notes. Both sides in the discussion of the bill, when it was pending in parliament, seem to have made the incredible blunder of overlooking the fact that gold could be obtained by the presentation of checks. This was exactly what happened in 1847 ..." (Charles A. Conant, *History of Modern Banks of Issue*, p. 125)

Apologists for this evil system may refer to this episode in its history as an "incredible blunder;" but when you stop to realize that this system has survived only because there were many such "incredible blunders," then you can't help concluding that the masterminds of the system knew what was going on.

With credit crises continuing as usual, it is interesting to read what one of the leading bankers of that time had to say:

> "It has been remarked that panics recur at regular intervals of about ten years each; nor can this be wondered at, seeing that the years 1825, 1837, 1847, 1857 and 1866 have, from various causes, been marked by the catastrophes so named. Judging by this recurrence of disasters at an apparently fixed period, it is not surprising that in the popular mind there seems to be a belief that a cycle exists, fated to bring in its train ruin to the monetary world and to millions outside of it. The dominant causes of the panics of the years specified, and their distinguishing characters, differ in some essential particulars. In one feature, indeed, they are all alike -- the unreasoning fear which heralds, accompanies, accelerates and sometimes produces them." (J.W. Gilbert, *The History, Principles, and Practise of Banking*, Vol. 2, p. 334)

There is certainly no justification for calling the fear of an inflated position an "unreasoning fear." Any sensible man knows the instability of an inflated position. He knows that if one needle does not prick the bubble, another will. Can an investor or producer in the capital goods industry be blamed for fearing the deflation he knows will occur? The very fact that the event feared always occurred would certainly suggest that there must have been some logical basis for the fear.

Some people will argue as follows:

> "If the public would not lose confidence, the system would never collapse. Therefore, all we need do is redouble our efforts to convince the public that they should not lose confidence."

But isn't it rather stupid of us to ask people not to lose confidence in such a system? Is the system sound or is it not? It is childish to say: "It is sound if confidence is not lost." If it were sound, confidence would never have been lost!

Confidence is the very foundation upon which the banking structure and our whole economic system is built. To say that our system is sound if confidence is not lost is the same thing as saying that your new house will be sound if the foundation is sound. If a builder made such a statement, he would naturally be told not to build the house without a sound foundation. But do we take that precaution with our economic system? No, we allow our bankers to engage in a practice that inevitably leads to a loss of confidence. There is no good reason for having confidence in a banking system that is allowed to create imaginary deposits against which checks can be drawn. Indeed, there are many sound reasons why we should not have confidence in such a system. And that is why we periodically have bank panics.

Any man who understands how our banks operate should know that our banking system is not sound. And our periodic panics are clear evidence that the great masses of people know that system is not sound, even though they do not know how our banks operate. Unfortunately, however, we do not understand the disastrous consequences of having an unsound banking system. We are not aware of the fact that herein lies the source of the poison that is strangling our free institutions -- slowly but surely. For with the development of what appeared to be a "business cycle," people began losing faith in a free enterprise system. Now that big business had sense enough to liquidate, and did, before the banks collapsed, they -- the businessmen -- were accused of being the cause of the deflation. It was claimed that business was liquidating because of "overproduction," "underconsumption," "misdistribution of income," "over-saving," "over-investment," and every other conceivable cause but the right one. The theory arose that Capitalism, the profit system, was incapable of self-regulation. People forgot that money regulates production through its effect on prices and therefore if production does not seem to be properly regulated, the blame should fall squarely on money, the instrument of regulation.

The critics of our economic system began clamoring for a "new order." They wanted "production for use" instead of production for profit. They failed to realize that production for profit is production for use. Nobody can make a profit by producing something that cannot be used. A properly functioning profit system -- which necessitates having a stable money -- makes it possible for people to produce and utilize more wealth than any other system that can be devised.

The most unfortunate thing, however, is that the person who attacks the profit system is unwittingly arguing for a slave state. Profit is not only the motivating force behind all productive activity, it is also the motivating force behind any free exchange of goods and services. In a free system, exchanges take place because it is profitable for both people participating in the exchange. If you eliminate profit, no production or exchange would take place except by coercion from a dictatorial government.

In spite of the fact that Marx's whole theory of Socialism has been repeatedly torn to shreds by economists and historians ever since it was first expounded, the idea has nevertheless survived and spread. The obvious reason why it has grown is that it offers an explanation of depressions -- even though illogical -- and a specific remedy for them. The failure of our educational system to teach the real cause of depressions inevitably encouraged the growth of Socialism and Communism.

The country that played such an important part in the development of credit banking (England) likewise produced one of the world's leaders in economic thought during the first half of the twentieth century -- the late Lord Keynes. Keynes's views of the business cycle are pinpointed in the following quotation:

> "Unemployment develops, that is to say, because people want the moon; -- men cannot be employed when the object of desire (i.e., money) is something which cannot be produced and the demand for which cannot be readily choked off. There is no remedy but to persuade the public that green cheese is practically the same thing and to have a green cheese factory (i.e., a central bank) under public control.
>
> "It is interesting to note that the characteristic which has been traditionally supposed to render gold especially suitable for use as the standard of value, namely, its inelasticity of supply, turns out to be precisely the characteristic which is at the bottom of the trouble." (Keynes, *General Theory of Employment, Interest, and Money*, pp. 235-236)

Now there is no question that the inelasticity of the gold supply is partly to blame for our troubles. The supply of gold does not keep pace with the growth of population. But isn't it clear that the greater part of our troubles has been due to the pyramiding of bank credit on this inelastic supply of gold? In other words, it was the highly elastic and unstable supply of bank credit that caused most of our troubles -- not the inelastic supply of gold.

Keynes's desire to get a substitute for gold is sound. The supply of gold is too inelastic. But his suggestion that we resort to the use of bank credit "under public control" is very unsound. In fact, this remedy is worse than the disease. It leads directly and inevitably to an all-powerful government -- a dictatorship. And the world is rapidly discovering that fact the hard way.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER VI - Part 1: Highlights of Colonial and U.S. History]

The American colonists did not have enough of the precious metals to serve as money. So they devised a money that served them just as well, if not better. Each colony issued its own "bills of credit" -- the first issue being made by Massachusetts in 169O. Most of the other colonies soon followed suit. These bills of credit were essentially "promises to receive" rather than "promises to pay." It is quite important that the difference between these two things be thoroughly understood. The English money that the colonists had had previous experience with was a promise-to-pay. It was paper money that was supposed to be redeemable in specie on demand. The colonists didn't like it because the promises were too often broken. It was a thoroughly bad money, and they knew it. So each colony issued its own money, which was not a promise-to-pay but rather a promise-to-receive. It was a promise that that money would be acceptable in payment of taxes. The colonists got along fine with this money as long as it was not over-issued. There was no cause for a contraction of this type of money as there was with the other type. But England did not like to see the colonists thriving under this independent system of money. She recognized the threat to her own system. So an Act of Parliament in 1763 declared all colonial acts for issuing paper money to be void. Benjamin Franklin protested vigorously against the Act, but without avail. This Act was undoubtedly one of the major causes of friction between the colonists and the mother country.

The Revolutionary War was financed, of course, by the Continental Currency. This experiment in paper money was grossly mishandled. William Berkey's observations concerning this epoch in our history are well worth noting:

> "The paper money issued by the several colonies prior to the Revolution had answered the purposes of money admirably, though not issued according to any well settled policy. Whenever it had a fair trial, however, it never failed to succeed. But Continental money was issued under very different circumstances. The colonies had been brought together not out of choice but by necessity. Congress assumed the powers which it exercised through necessity, and its acts were acquiesced in by the people only out of a spirit of patriotism. Congress had no power to lay and collect taxes, and the confederation was without revenue. Whatever was done, had to be done through the States. Even after the adoption of the Articles of Confederation, in 1791, Congress possessed only the semblance of authority.....
>
> "The population of the thirteen colonies was estimated in 1775 at 2,448,000, and the entire property of the country at less than $600,000,000. *That a paper currency, issued to an excessive amount, by thirteen sparsely settled colonies, in a state of rebellion, under a revolutionary government possessing only a shadow of authority, against the most powerful nation on the earth, should have circulated at all, is one of the most remarkable facts connected with the Revolution and is to be accounted for only by the patriotism of those engaged in that memorable struggle*. But as we have seen, it circulated for over a year at par with silver, and in 1778, three years after the first emission, it depreciated only to $1.75 for $1. Congress resorted to various measures to sustain the credit of Continental bills, but, as ought to have been expected, without success. ....

> "*It is worthy of note, too, that Continental bills were not issued in the form of paper money, such as was first introduced by Massachusetts, and subsequently adopted by many of the other colonies, but in the form of promises-to-pay specie, at certain specified times, which under the circumstances, was a manifest impossibility*. The gradual depreciation of Continental money, as it passed from hand, inflicted a loss upon each successive holder, which came to be regarded in the nature of a tax or contribution towards the cause of independence. The large sums held by individuals after it ceased to circulate were taken at its greatest depreciation, and no great loss was sustained. When, after it had seen the liberties of the people vindicated, it sank, in the moment of victory, quietly into its grave, no commercial crash or money panic attended its fall. Its ghost has troubled no one since, except the advocates of the British system of bank currency, which, perhaps, is only in accordance with the eternal fitness of things." (William A. Berkey, *The Money Question*, pp. 114-117) (Italics added)

Under the Constitution framed in 1787, the colonies wisely surrendered all power and control of the money question to the new Federal Government. They did this in order to secure for themselves a uniform and stable medium of exchange. There was a clause in the Constitution expressly prohibiting States from coining money and emitting bills of credit. But it wasn't long before banks of issue -- operating on the British system -- were doing within each State what in essence the States were forbidden to do.

It was Alexander Hamilton, first Secretary of the Treasury, who was responsible for the establishment of the first Bank of the United States. Hamilton was a great admirer of British institutions. He favored a strong central government. He had little faith in democracy. In a speech on this subject June 18, 1787, he said:

> "All communities divided themselves into the few and the many. The first are the rich and well born, the other the mass of the people. .... Can a democratic assembly, who annually revolve in the mass of the people, be supposed steadily to pursue the public good? Nothing but a permanent body can check the independence of democracy. Their turbulent and uncontrolling disposition requires checks." (Yates's *Debates of the Constitutional Convention*)

There is a tremendous amount of truth in what Hamilton said if we start with the assumption -- as Hamilton did -- that the British system of credit banking was going to be used in this country. Unquestionably under that system "all communities divide themselves into the few and the many." And in a democracy, "the mass of the people" will demand reforms that will hinder the proper functioning of that banking system. But there was no need to have our country divided into "the few and the many" if we would only have had the wisdom to keep the English system of credit banking out of our country.

Although Hamilton's views on a strong central government were understandably rejected by the constitutional convention, he was successful in getting the first Bank of the United States established in spite of the opposition of Thomas Jefferson, then Secretary of State, and Madison, who declared it a violation of the Constitution. When the bank applied for recharter in 1811, it was not granted. Clay and other leading statesmen opposed it on the grounds that it was "unconstitutional, anti-American, and strictly a British institution."

By 1815 the mania to start banks had swept the country to such an extent that Jefferson estimated there must have been one hundred of them. Berkey's comments on this development are very pointed:

> "Notwithstanding the constitutional prohibition against emitting bills of credit, charters, incorporating private institutions, authorized to emit bills of credit (bank notes), were granted by the legislatures of the several States in large numbers, in utter disregard of the Constitution, as well as of the public good. In Pennsylvania, for example, twenty-five charters, incorporating specie basis banks of issue, were granted during the session of 1813, but were vetoed by the Governor. At the next session of the legislature, in 1814, a bill was passed over the veto of the Governor chartering forty-one banks, with a capital of $17,000,000. Thirty-seven of them went into operation at once, and six months afterwards suspended specie payment. The manner of obtaining a charter was very simple. A petition setting forth 'the wants of the people' in the locality where the bank was to be established was all that was required; political influence and intrigue accomplished the rest.

"Specie basis banks are always required by law to redeem their notes in specie, but as they are also, always authorized to issue notes to three times the amount of their capital stock, their redemption in specie becomes an impossibility. This feature in banking, as has been explained, was originally nothing more than a bold plan on the part of certain ingenious financiers and schemers to acquire favor with the public for the Bank of England and increase its business. As the system in time was found to have a tendency to concentrate wealth in the hands of the few, it commended itself to the aristocratic, or governing class, of that kingdom, and soon became an integral part of the structure of British society. Transplanted to the free atmosphere of America the system was afforded an opportunity to develop its latent evils, greatly to the disadvantage of American society. ....

"It is, as we have seen, a part of the specie basis system to treat discounted paper as deposits, and this furnishes the basis for additional loans of credit. By encouraging discounts and lending credit, through the instrumentality of bank notes, to be used as real capital, business becomes active, prices advance and speculation becomes rife. Inflation of bank credit and notes goes on and a huge structure of credit is erected upon an insignificant basis of specie, supposed to be resting in the vaults of the bank, which is toppled over by the first financial breeze that springs up, and the public is buried in its ruins. When the banks are called upon to redeem their promises to pay they are of course unable to do so, for the wit of man has not yet devised a way to redeem several paper dollars with one gold dollar. Like individuals, banks can be thrown into bankruptcy and compelled to go into liquidation, but such a step only aggravates the distress of the public, and is rarely adopted; and the banks are permitted to escape, only to repeat the operation as soon as confidence has been restored through the aid of the Sheriff. ....

"The banks of the United States have been compelled to suspend specie payments at various times as follows, to wit: in 1809, 1814, 1819, 1825, 1834, 1837, 1839, 1841, 1857, 1861, and in 1873 currency payment. These suspensions have invariably occasioned great public distress, and in several instances have involved the entire country in bankruptcy and ruin, from which it took years to recover." (Berkey, *The Money Question*, pp. 120-124)

The second Bank of the United States was eventually chartered and opened for business on January 1, 1817. Berkey tells what happened:

"In 1818 the bank of the United States had discounted to the amount of $43,000,000, and had $2,000,000 in specie. It had established eighteen branches, and its notes could not be signed fast enough for the public. To increase its reserve of specie it had bought $7,000,000 of bullion abroad, at a cost of $800,000 for expenses, but it was exported as fast as it was imported. The Bank of England, which had been in suspension since 1797, was preparing to resume specie payments, and was drawing specie from every source that was available. In April, 1818, less than fifteen months after the Bank of the United States started, it was believed to be insolvent. A committee, appointed by Congress to investigate its affairs, reported a resolution requiring the bank to show cause why its charter should not be forfeited, but the resolution was lost, forty members of Congress being stockholders in the bank. The bank now resorted to vigorous measures to save itself from bankruptcy, and in a little over two months was once more solvent. It had, however, ruined the country. The amount of bank note circulation in 1813-14 was about $45,000,000; in 1817-18, $100,000,000; and in 1819 about $45,000,000. Contraction had done its work, and the ruin which it had accomplished was deep and widespread." (Berkey, *The Money Question*, pp. 127-128)

President Jackson led the fight to prevent renewal of the charter of the second United States Bank. In 1832, he clearly presented the dangers of the system:

"Is there no danger to our liberty and independence in a bank that in its nature has so little to bind it to our country. The president of the bank has told us that most of the State banks exist by its forbearance. Should its influence become concentered, as it may under the operation of such an act as this, in the hands of a self-elected directory, whose interests are identified with those of the foreign stock-holders, will there not be cause to tremble for the purity of our elections in

> peace, and for the independence of our country in war?" (Davis R. Dewey, *Financial History of the United States*, p. 203)

Concern for the "purity of elections" was evidently justified. One of our leading historians, the late Charles Beard, said there is incontestable proof that in 1837 the country, besides having a finance-controlled press, was deliberately put into a state of financial paralysis by the banks for political motives! (Charles Beard, *Rise of American Civilization*, Vol. 1, pp. 567-568)

But although Jackson won the battle to prevent renewal of the charter by Congress, the bank continued to fight him for several more years:

> "Its charter expired by limitation in 1837, but it was entitled to two years in which to wind up its affairs. Instead of preparing to close up its business it resorted to new and desperate measures to prolong its powers. In January, 1836, a bill was 'snaked' through the legislature of Pennsylvania, by means of bribery and corruption, entitled 'An Act to repeal the State tax, and to continue the improvement of the State by railroads and canals, and for other purposes;' and under the vague generality of 'other purposes' was found a charter for the United States Bank, adopting it as a State Bank. The people of Pennsylvania were astounded, and met in masses to denounce the act and demand its repeal; and at the next session of the legislature an investigation was ordered, but, as is usual in such cases, it came to nothing." (Berkey, p. 144)

Whenever banking reforms were discussed in this country, the same "incredible blunders" that England made in 1844 were made here. We failed to realize that there is no basic difference between notes and checks. Berkey gives an example of the parallel development that took place in this country:

> "On the 10th of December, 1861, the Secretary of the Treasury submitted his annual report to Congress. He set forth in strong terms the weakness and disadvantages of the banking system of the country, and expressed the belief that *the emission of bills of credit by state banks was in violation of the spirit, if not the letter, of the Constitution*. He said: 'It has been well questioned by the most eminent statesmen whether a currency of bank notes, issued by local institutions under State laws, is not in fact prohibited by the national Constitution. Such emission certainly falls within the spirit, if not within the letter of the constitutional prohibition of the emission of bills of credit by the States, and of the making by them of anything except gold and silver coin a legal tender in payment of debts. However this may be, it is too clear to be reasonably disputed, that Congress, under its constitutional power to lay taxes, to regulate commerce, and to regulate the value of coin, possesses ample authority to control the credit circulation which enters so largely into the transactions of commerce, and affects in so many ways the value of coin. In the judgment of the Secretary, the time has arrived when Congress should exercise this power.'" (Berkey, pp. 173-174) (Italics added)

Berkey proceeded to quote Secretary Chase's description of his plan for reform, and then said that after eulogizing the plan, Secretary Chase added the following comment:

> "The Secretary entertains the opinion that *if a credit circulation in any form be desirable, it is most desirable in this*." (Berkey, p. 175) (Italics added)

The fact is, as we have seen, that a credit circulation in any form is not desirable. All plans to make a credit currency work are doomed to failure because of the inherent instability of bank credit. Secretary Chase pointed out that the most eminent statesmen looked upon a currency of bank notes issued by local institutions as being prohibited by the Constitution. He further pointed out that Congress, under its constitutional power to regulate the value of coin, possesses ample authority to control the credit circulation which enters so largely into the transactions of commerce, and affects in so many ways the value of coin. But Secretary Chase was making the same "incredible blunder" as the members of the Currency School in England made in 1844, i.e., he was failing to see that there is no fundamental difference between notes and checks. He failed to realize that if a currency of bank notes issued by local institutions is unconstitutional, then a currency of bank checks drawn on those same institutions is equally unconstitutional. As might be expected, therefore, when the National Banking System was established in 1863, nothing was done to curb the power of banks to create money by creating imaginary deposits subject to check.

The damaging effect of this credit system in the United States was seen in many ways. One of the evil effects was that it fostered a concentration of wealth in the hands of a few. By the power to create money, the banking system financed stupendous consolidations that would never have existed otherwise. An example of this was given by Elgin Groseclose:

> "The VanSweringens achieved control of the Chesapeake and Ohio railroad with an ownership of less than 1 per cent of the stock, and the means they used to dominate a railway property that stretched across the continent, ... was a pyramiding of holding companies in which they had an initial investment of $1,700,000. Despite their professions of faulty hearing and memory Mr. Ferdinand Pecora was able to draw out from the brothers that this $1,700,000 had been obtained by a bank loan." (Groseclose, *Money: The Human Conflict*, p. 258)

The point that needs emphasis above is that the loan of $1,700,000 received from the bank was a creation of new purchasing power by the bank rather than a transfer of existing purchasing power. A bank had created the purchasing power that permitted the VanSweringens to get control of the C & O Railroad.

As Jerry Voorhis, an able critic of the system, pointed out in his book Out of Debt -- Out of Danger:

> "To permit any private citizen or corporation to create money with which to buy factories, railways, mines, or shipyards produced by the labor and intelligence of others is to violate every principle of decency, morality, and economics." (p. 105)

Still another evil inherent in credit banking was the manner in which it fostered the growth of monopolies by stifling any opposition. How this was done is well explained by Horace Coon in his book *American Tel. and Tel.*, pp. 107-108:

> "Meanwhile the bankers used their influence to prevent the financing of large independent units. The building of a 'natural monopoly' was made possible by the virtual monopoly control of investment capital possessed at that time by the J. P. Morgan group. Their opposition stopped the financing of a long distance line between Kansas City, Chicago, and New York. They also prevented the development of an independent company in Wisconsin. The Baker-Morgan group brought pressure on financial organizations and institutions when appeals were made by independents for financing. Morgan at that time had the money power to discourage local bankers who might run counter to his wishes. So the independents discovered that investment capital was, to put it mildly, distinctly unsympathetic. The larger the independents became the more difficult it was for them to obtain financing in the large amounts they required. A slow financial strangulation thus dried up the sources of necessary funds and made more invincible the position of the Bell System."

There is a lesson in the above quotation for those who advocate a government-controlled system of bank credit. A logical and inevitable result of a concentration of banking power -- whether by government or by private interests -- is the stifling of competition. We no longer have the monopoly of credit that existed in Morgan's time -- but we are rapidly headed toward a monopoly of credit in the form of a government-controlled banking system.

The panic of 1907 demonstrated the instability of our banking system so well that a National Monetary Commission was established to make a thorough study of banking. But the results were sad -- to say the least. Instead of admitting that our periodic panics were caused by the "elastic" element of our banking system, our experts designed a new system whereby bank credit could be stretched further than ever before. Indeed, it was argued that lack of sufficient elasticity was the cause of the trouble! It was claimed that the rigidity of note issue under the national banking system led to the embarrassment of the banks when depositors became panicky. The banks -- as a result of creating imaginary deposits -- were embarrassed when too many of their depositors said, "Pay me." Instead of admitting that the cause of the trouble was the action of the banks in creating imaginary deposits, the experts said the cause of the trouble was that the banks could not get hold of more notes during an emergency.

It did not seem to occur to them that even if the banks could get hold of more notes, it would be impossible to convert the notes into gold. Another one of those "incredible blunders."

The result of this unsound reasoning was our so-called "panic-proof" Federal Reserve System -- the system that gave us the biggest boom and biggest collapse we ever had.

The noted financial journalist, C. W. Barron, knew what was happening when the Federal Reserve Act was passed. He wrote:

> "The purpose of the act most largely in its inception was 'for other purposes,' and these 'purposes' can never be wisely or effectively carried out; if persisted in they spell disaster to the country. The hidden purpose or 'motif' which inaugurated this legislation, however in effect it may work out under wise administration, is to cheapen money." (Requoted from Groseclose, op. cit., p. 223)

Elgin Groseclose explains how money was "cheapened:"

> "As the reserves held by member banks against their deposit liabilities are concentrated in the Federal Reserve Banks, so these reserves in turn constitute deposits with the Federal Reserve Banks. Against these deposits, which are the prime reserves of the commercial banks, the Federal Reserve Banks are required to hold, as a minimum, gold to the extent of only 35 per cent. In other words, just as commercial banks may expand their liabilities on the basis of small amounts of cash, so the Federal Reserve Banks may expand their liabilities upon small amounts of gold. This is achieved by permitting member banks to strengthen their reserves with the Federal Reserve Banks by borrowing upon the security of government bonds and by the discounting of their commercial paper. If a bank wishes to expand its operations, and has not the cash for the minimum reserve requirements it may, in effect, create a fictitious reserve by borrowing the credit of the Federal Reserve Bank. The only limit is the legal restriction upon the Federal Reserve Bank against permitting its gold reserve to drop below the 35 per cent minimum ratio to its deposit liabilities. Thus if the average reserve held by the commercial banks against their deposits may be taken as 10 per cent, and the gold reserves held by the System against those reserves at 35 per cent, the actual gold held against the commercial deposits of the System might be reduced to as low as 3.5 per cent." (Ibid., pp. 227-228)

A fine way to prevent panics! Admittedly, reserves were made more mobile by the Federal Reserve System -- i.e., they could be quickly moved to whatever section of the country needed them. But with still less reserves than before, what good is this mobility if confidence is lost in several sections of the country at the same time?

The following statistics give an idea of the extent to which money became inflated during the period 1865-1930: In 1865, the ratio of gold to total note and deposit liabilities of all banks in the United States was 25.3 per cent. This dropped to 23.9 per cent in 1880, 20.45 in 1900, 14.2 in 1910, and 10.4 per cent in 1930.

Obviously we were "riding for a fall" all during the 1920s. From his vantage point as an analyst for the Guaranty Trust Co. of New York and with the experience that comes from years of watching the money market, Groseclose clearly depicted the events leading up to the Great Depression. His description of those events -- together with his pointed analysis of the basic flaw in our system -- is given in the following passages:

> "During the post-war years [author's note -- the 1920s], after a temporary deflation, the process of inflation abroad had been resumed through the use of bank credit, and in frantic efforts to support this expansive growth, a world scramble for gold reserves began.

"Despite the feverish activity of the gold mines, which were turning out the precious metal in a perfectly enormous quantity -- an average of nearly 20,000,000 ounces ($700,000,000) a year, a gold famine prevailed. The trouble was that no amount of gold would have sufficed, for as rapidly as it was added to the stores of the central banks, new bank credit was created.

"By the beginning of 1929, four countries -- the United States, France, the United Kingdom, and Germany -- had increased their gold holdings by 2.4 times over pre-war, and held 59 per cent of world gold reserves as against 49 per cent at the end of 1913. In 1929, the ratio of cash to total bank deposits in these countries stood as follows: United Kingdom, 11.3 per cent; France, 7.4 per cent; United States, 7.3 per cent; Germany, 3.1 per cent.

"Thus, while lesser countries were trying to lay hold of gold by the deceptive device of borrowing it, or multiplying its effectiveness by the gold exchange standard, the greater, by the manipulation of discount rates and the application of tariff barriers, were effectively retaining, and adding to, their existing supplies.

"When American investors began to grow wary of the tremendous amounts of foreign borrowing in New York, and the bond market suddenly broke in May, 1928, one stimulus to artificial gold movements was removed, and in the lesser countries the pinch of gold shortage began to grow acute. In England, in August of the following year, a group of speculative enterprises built up by a promoter by the name of Clarence Hawtrey suddenly collapsed when Mr. Hawtrey was caught in defalcations and sent to prison. Investors began to sell to realize cash, and American securities held in England began to be offered on the New York Stock Exchange. In New York, speculation had gone so far that it took only a pin prick to rupture the bubble, and in October a crash occurred which rocked the world. On October 24, no fewer than 12,894,650 shares were sold on the New York Stock Exchange amid scenes of wild panic. Shares of General Electric Company dropped 47.5 points, Westinghouse Company, 34.5, Allied Chemical and Dye Company, 36 -- and these were typical of the market as a whole. A half dozen of the largest banking houses attempted to support the market by an emergency pool, but in vain. On October 29, the market sank in a new collapse, the gigantic total of 16,410,030 shares being sold. At the end of the first year of the crash, an aggregate deflation of $40,000,000,000 in the value of New York Stock Exchange Securities had resulted.

"But the stock exchange collapse was but the splendid conflagration that marked the close of an era. A gnawing flame had for years been creeping through the withered dry grass of banking. Its toll is to be read in the record of bank failures during the dazzling decade of the 1920s. In the nine years ending 1929, 5,642 banks had failed, an average of 629 a year. When it is realized that each bank represents a community of depositors, whose businesses and homes and personal security are often entirely dependent upon the safety of their funds, and that the effect of the bank failures represented, in effect, the destruction of the economic life of 5,642 separate communities, the bitter blight of suspensions can be more clearly visualized. It was a situation which not the strongest nation could long endure.

"The stock exchange collapse revealed to the world the whole flimsy character of the financial situation, and as the eyes of men widened in distrust and suspicion, the debacle spread. In the United States, banks began to suspend in increasing number -- 1,352 in 1930 and 2,294 in 1931 -- trade dried up, and commercial failures increased. Huge industrial combinations began to disintegrate. Ivar Kreuger, whose Swedish Match Company had been banker to governments, committed suicide as his paper towers fell to pieces. Samuel Insull, czar of a utility empire, fled from his domain as the law cried vengeance.

"Abroad the gold standard was everywhere falling. In the spring of 1931, the principal commercial bank of Austria -- the Credit-Anstalt -- failed. This involved Germany, and in July President Hoover proposed his famous moratorium on reparations payments. This was extended to private payments, under the 'stand-still' agreements. But England was now involved, because of its inability to withdraw its German credits, and when a run on British gold began from abroad, it was too weak to survive. The suspension of gold payments by the Bank of England in September, 1931, was a world catastrophe, and by July, 1933, of the major countries of the world only Belgium, Switzerland, France, The Netherlands, Italy and Poland could be classified as on the gold standard.

"Efforts made in this country to deal with the situation that had developed were futile for the simple fact that the only remedy applied was the same old nostrum -- more credit. The Federal Reserve Banks, in the hope of breathing a new life into the exhausted spirit of credit, had by May, 1931, reduced the discount rate to 1.5 per cent (in New York) and were flooding the market with reserve credit by open market purchases. During the early years of the depression, the problem was still one of banking -- technical insolvency due to a drop in the value of investments and actual insolvency due to an inability to liquidate loans and investments. The government currency was still unquestioned. To aid the banks, the banking and currency laws were relaxed by a series of measures. Early in 1932 (January 22) a huge lending corporation, the Reconstruction Finance Corporation, was created with a credit power of $2,000,000,000 supplied by the United States Treasury, to bolster the credit structure of the country by loans to embarrassed banks, insurance and other financial companies, to railroads, to states and political bodies, and finally to certain types of private corporations. All these efforts were to no avail. Business revived slightly in 1932, then a new wave of bank failures swept the country, a foreign run on American gold reserves began, and the virus finally reached the government monetary system itself. Everywhere deposits were being withdrawn in gold and government paper money was being presented to the Federal Reserve Banks and the United States Treasury for redemption in gold. In February, 1933, banks began to close their doors in whole sections of the country, and when Franklin D. Roosevelt took over the reins of government from Herbert Hoover, on March 4, he faced a great nation in which every bank was closed tight. By nightfall the redemption of money in gold had been definitely suspended by the wealthiest government in the world.

"As we survey the monetary situation in this country we discover that the distortions and convulsions which developed were the result of a people relying increasingly upon money to facilitate its commercial exchanges, while at the same time progressively weakening and deteriorating its money system. We had built a vast and splendid structure of technical economy, of organized commerce and integrated industry, upon the foundation of money, and while we were building this structure we were undermining the foundation by the device of deposit credit. We saddled upon money the burden of our entire economic functioning, the complicated and extensive machinery for the creation and distribution of goods, and then progressively weakened our money until it was no longer able to support the weight. In the years preceding the great stock market collapse of 1929 we had been going through a progressive inflation of the money, comparable in character, if not in degree, to that which occurred in Europe after the World War.

"Under the conditions that grew up around a situation of constantly expanding banking operations based on steadily diminishing reserves it was inevitable that a crash should occur. There was too little gold to support these vast commitments of the banking system to pay out on demand gold (or lawful money which in turn was redeemable in gold) against demands for withdrawal. The stupendous house of banking had been built upon sand -- public confidence in the infallibility and capacity of the institution -- and when the sand began to shift, the whole structure toppled like an Egyptian monolith." (Groseclose, *Money: The Human Conflict*, pp. 241-245)

Some idea of the speed with which the panic of 1933 spread over the country can be obtained from Frederick A. Bradford's chronological record of events given in his book *Money and Banking*, a standard textbook on the subject:

"The year 1933 opened with 237 bank suspensions in January. Confidence was badly disturbed in different sections of the country, and it had been found necessary for various political authorities to declare local banking moratoria in certain regions to prevent the complete collapse of banking facilities. The seriousness of the situation was not generally recognized, however, until February 14th, when Governor William A. Comstock declared a bank holiday for a week for all of the banks in the State of Michigan, as a result of difficulties in the Detroit area. Nothing short of a tremendous cash loan would have prevented the failure of one of the large Detroit banks with disastrous results. The necessary loan could not be arranged, and Governor Comstock's proclamation followed.

"The closing of the Michigan banks not only alarmed frightened depositors in other sections of

> the country but set up a drain of cash from other regions into the Michigan area. Large corporations operating in Detroit withdrew deposits in cash from neighboring states and from New York in order to meet the demands of their own creditors. Under such circumstances, restriction of payments by banks in other states was inevitable. On February 23rd, Indiana joined Michigan in limiting banking activities to a nominal basis. Maryland followed on the 25th, Arkansas on the 27th, and Ohio on the 28th. From this point on, state banking moratoria increased rapidly in number, as shown in the accompanying list, until the morning of March 4th, when practically all of the remaining banks of the country suspended operations." (pp. 375-376)

What a spectacle! The leading industrial nation of the world laid low by a collapse of its banking system! Our previous period of prosperity had been built with imaginary money (bank credit). And when we questioned the existence of that money -- down tumbled our entire economic system.

In spite of the fact that our so-called "panic-proof" banking system once more was shown to have no more strength than a house of cards, most people are still of the opinion that the system is sound! At least I assume this is so, because no steps have been taken to change the basic structure of the system. There are three probable reasons that account for our blindness: 1) The "experts" are still confused with their own complex theories put forward in a vain effort to show why the system is sound; 2) The public has been following the advice of these experts instead of thinking the problem through for themselves; 3) The public thinks the shortcomings of the system have been correctly remedied by the Federal Deposit Insurance Corp. (to be discussed later).

I well remember the day I discussed the events leading up to the Bank Holiday with an economist serving in an advisory capacity for one of the large banks in San Francisco. When I referred to the last panic, he said: "That was not a panic." I asked him what it was if it wasn't a panic. There was no answer.

I have since read several statements of economists who have offered an explanation for what happened in 1932-33. They say that the banking crisis was the result of "political disturbances." Their argument is that because President-elect Roosevelt openly conferred with a group favoring a paper money standard, there was a loss of confidence that led to hoarding and bank runs.

Now there is no question but that this "political disturbance" was probably the needle that pricked the bubble and set off a further deflationary spiral. But isn't it a little shortsighted to blame our troubles on the needle that pricks an inflated balloon? Isn't it shortsighted to build our complicated economic system on a banking system that can be destroyed by a rumor?

Other economists will argue that the banks collapsed because of "unsound" or "unwise" extensions of credit. But isn't it obvious that when people run on a bank, they don't stop to think whether that bank has been extending credit "wisely" or "unwisely." As a matter of fact, the people don't know. They run on the bank for the simple reason that they know that the bank doesn't have enough cash to pay all depositors. They know that if they don't get there first, they may lose their deposits.

In a very real sense, however, the banks do fail because of "unwise" or "unsound" extensions of credit: All their extensions of credit are unwise and unsound. It is not sound for a banker to create imaginary deposits against which checks can be drawn. It is not sound for a banker to short-sell our legal standard of value. It is not sound for a banker to give an implied promise to do something that he knows is physically impossible to do.

Following the collapse of 1933, most of the banking theorists still couldn't see the forest for the trees. However, Groseclose, whose description of the events leading up to the great debacle was given earlier, pinpointed the main cause of our troubles and suggested the logical remedy as follows:

> "The attempt to give universal gold liquidity to wealth, by the device of bank credit, is a specious and deceptive one, leading us like a will-o'-the-wisp into the morass of panic and depression. Bank deposits subject to check, by means of which today some 95 per cent of all monetary transactions are consummated, must be made fully representative of money; in other words, the ideal toward which monetary reform must strive is a return to deposit banking as it was practiced in Venice, in Amsterdam, in Hamburg, and elsewhere in Europe before the appearance of credit banking.

"Sooner or later we must abandon the pretense that we can eat our cake and have it, that we may have money on deposit ready to be withdrawn at any moment, and at the same time loaned out in a thousand diverse enterprises, and recognize that the only assurance of liquidity of bank deposits is to have the actual money waiting on the depositor at whatever moment he may appear." (Ibid., pp. 272-273)

Many other economists were coming to substantially the same conclusions as Elgin Groseclose. Among these were: Irving Fisher, Charles R. Whittlesey, Frank D. Graham, Henry C. Simons, Paul H. Douglas, Lloyd W. Mints, John R. Commons, Earl J. Hamilton, W. I. King, and James W. Angell.

But it's one thing to find the trouble -- and quite another thing to get it corrected. In his inaugural address, President Roosevelt severely criticized our banking system:

"Plenty is at our doorstep, but a generous use of it languishes at the very sight of the supply.

"Primarily, this is because the rulers of the exchange of mankind's goods have failed through their own stubbornness and incompetence, have admitted their failure and abdicated. Practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men.

"True, they have tried, but their efforts have been cast in the pattern of an outworn tradition. Faced by failure of credit, they have proposed only the lending of more money.

"Stripped of the lure of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for restored confidence. They know only the rules of a generation of self-seekers.

"They have no vision, and when there is no vision the people perish.

"The money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths."

Unfortunately these were just fine words and no more. Roosevelt either lacked the wisdom or the support to "restore that temple to the ancient truths."

In discussing what should have been done, we should bear in mind that if the correct measures had been taken as soon as the stock market collapsed, the severity of the depression would have been decreased enormously. If, for example, the Hoover Administration had faced the problem squarely and converted our banking system into a 100% reserve system by the process described in Chapter VIII, there would have been no cause to fear a collapse of the banking system, i.e., the stock market bubble could have burst without destroying our monetary system. As it was, however, Hoover had to plead with the people not to withdraw their deposits from the banks; because for each dollar they withdrew, the banks would be forced to curtail loans by ten times that amount -- thus adding to the deflationary spiral. But it's too much to expect people to heed such a warning. If the banks were not in a sound position, as a result of having created billions of dollars of imaginary deposits, then the government should have put them in a sound position instead of asking us not to lose confidence in them.

After the collapse of the banking system, the problem of what to do became complicated by many factors. It would have been too late then to merely put our banking system on a sound basis and let nature take its course. That would have ignored the fact that part of the country's supply of money -- even though imaginary -- had been destroyed (by bank failures and contractions of credit) causing a great amount of injustice. It was imperative that the supply of money be restored to its former quantity as rapidly as possible, and relief to debtors granted in the meantime. No attempt should have been made to redistribute wealth by taxation, because the collapse had not been caused by a maldistribution of wealth. Furthermore, a tax program based on a redistribution of wealth would obviously delay recovery by putting a damper on those who are largely responsible for creating jobs in our free enterprise system. The cause of our collapse -- let us bear in mind -- was a justifiable loss of confidence in our banking system. Businessmen can't be expected to reinvest part of their earnings -- or distribute those earnings as dividends -- or continue production as usual -- when they anticipate trouble with the banking system. No sane individual spends his savings when he is expecting financial trouble in the near future. But obviously, as soon as businessmen commence to curtail operations, the flow of savings into investments dries up, jobs fall off, and the downward cycle is in full swing.

The proper remedial measures should, therefore, have been to convert our credit banking system to a deposit banking system; pass legislation to relieve debtors, and take immediate steps to restore the amount of money that had been destroyed by the deflation of bank credit and bank failures. This latter measure could have been accomplished by having the government reduce taxes below Federal expenditures by $8 billion (representing the eight billions of bank credit that had been destroyed).

Our reform should have been confined to the measures given above. Private enterprise was in no sense to blame for the depression, and therefore should not have received any blame for it. But instead of that, the leaders of our free enterprise system became the scapegoats. And for the next 18 years, the enterprising men to whom we owe so much -- those who create the jobs and take the risks of opening new businesses -- were subjected to the most scurrilous attacks imaginable.

It is understandable, however, that private enterprise was held responsible for the collapse. To all outward appearance it was responsible. Production had stopped because confidence had been lost. And it was assumed that confidence had been lost for reasons inherent in the free enterprise system. It was pointed out that when savings and business earnings are allowed to accumulate as idle or hoarded funds, a deflationary spiral will set in. And the theory was advanced that a maldistribution of income was the basic cause of the accumulation of idle money. For example, Marriner Eccles -- in his book Beckoning Frontiers -- makes the statement:

> "Had there been a better distribution of the current income from the national product -- in other words, had there been less savings by business and the higher-income groups and more income in the lower groups -- we should have had far greater stability in our economy." (p. 77)

But it should be clear that the distribution of income had absolutely no bearing on the weakness of the banking system. Fear of a banking collapse would have occurred just the same. And when the depression came, it would have been even more severe. Many businesses were able to keep operating at a loss during the depression by dipping into their savings. Had they not had those savings, there would have been still fewer jobs.

The point that is overlooked by those who have accepted the maldistribution theory of depressions is that there is no proof whatsoever, and no valid reason for believing, that an accumulation of idle funds is the result of "over-saving" or a maldistribution of income, whereas there are many valid reasons for believing that savings are periodically left idle because of a fear of impending trouble with the banking system.

(Once more, I wish to point out that it is only the largest manufacturers engaged in long-term production that can be expected to be keenly aware of the weakness of a credit banking system. When they start to liquidate, bankers know that confidence has been lost in the liquidity of the banking system and that nothing but a liquidation of bank credit will restore confidence. Naturally, confidence is then lost in the general business outlook, and a full-scale depression sets in with a vengeance.)

Because the Administration had an erroneous idea of the cause of deflation, the remedy applied was equally erroneous. The government borrowed from the banking system to finance a Public Works program (the objective being to restore -- by "reflation" -- the pre-depression supply of money as soon as possible). We also instituted that bane of a free enterprise system -- a tax program aimed at a redistribution of wealth. Both of these courses of action were quite harmful and undoubtedly did much to keep us from achieving full employment prior to the outbreak of World War II.

It is true that in the absence of any basic change in the banking system the government had to embark on an era of deficit financing in order to bring about an immediate expansion of the supply of money to the pre-depression level. There was no other practical way to accomplish that task given that type of banking system. Eccles saw this very clearly. He knew that the advice of Bernard Baruch and other orthodox economists was not practical under the circumstances (their advice was to balance the budget and let nature take its course). Eccles knew that the grinding down of prices and wages that would result from such action might very well have led to a revolution. Prices and wages had been inflated terrifically in terms of gold by the expansion of gold-credit that had taken place during the 1920s. If we followed Baruch's advice, we were in line for a drastic deflation of prices and wages. And although we would eventually recover, it wasn't reasonable to expect 12 million idle men in the presence of idle machinery to wait that long.

The orthodox banking theorists took the stand that a liquidation of bank credit would be a "wholesome" thing. And in terms of the proper functioning of the gold-credit mechanism, they were right. Confidence was not going to be restored until a deflation of credit took place. But obviously a contraction of the supply of money is not a wholesome thing in terms of the effect it has on human beings.

To recapitulate: We had a choice of three courses of action after the bank panic:

1) Stick to the gold-credit mechanism and follow the sound economic principles of a free market.

2) Stick to the gold-credit mechanism -- with a few patches -- and adopt the unsound economic principles of a managed economy.

3) Convert our unsound credit banking system into a sound deposit banking system -- taking care to restore the per capita supply of money to its pre-depression level -- and continue to follow the sound economic principles of a free market.

If I were forced to choose between 1 and 2 -- as all people who assumed that credit banking is sound were obliged to do -- I suppose I would have taken the second choice out of sheer desperation. I would know -- deep down in my heart -- that it couldn't work because it was based on false premises and unsound economic principles, and unsound theories of government. But because of the injustice, and misery and probable revolution that would have resulted from a drastic deflation of prices and wages if we followed the first course of action, I would have resigned myself to the second choice. The great majority of Americans indicated that they felt the same way.

Now let's discuss some of the measures that were taken, after the bank holiday, to restore confidence in the banking system. Perhaps the most significant step that was taken was the nationalization of our gold supply. No longer did any citizen have the right to hoard gold or to obtain gold by presentation of Federal Reserve Notes. No longer did private individuals have the power to cause a contraction of credit by withdrawing gold.

In one sense, this was a step in the right direction. No private individual or corporation should have the power to cause a contraction of our supply of money by withdrawing gold from the banking system. But neither should our government have the power to arbitrarily cause an increase or decrease in the supply of money (bank credit). All recorded history shows that when governments have that power, they will abuse that power by inflating the supply of money.

There is only one way for us to protect ourselves from both private and government abuse of our money. We must have our Constitution state what the per capita supply of money should be. Our Constitution is our only safeguard. It protects us from other abuses by the government -- and it should protect us from the government abuse of our monetary system also.

Another important step that was taken to restore confidence in the banking system was the establishment of the Federal Deposit Insurance Corporation. A word or two about that organization should be of interest to the reader. It was designed to bolster confidence in the banking system by making it appear as though the United States Government was guaranteeing the safety of your deposits. Actually it merely insured individual deposits of member banks up to $5,000. Deposits were not guaranteed.

It is amusing to remember that one of the arguments used to justify a system of credit banking was that banks operate as insurance companies. We now see that since the banks could not make good when operating as insurance companies, it became necessary to create the Federal Deposit Insurance Corp. to insure the banks! And the next thing we will need will be some agency to insure the Federal Deposit Insurance Corp., because it is just as unsound as the banks. In 1946, for example, there were approximately sixty-six billion dollars of deposits under $5,000 insured by the F.D.I.C. -- which had about one billion dollars in assets. Today deposits are insured up to $10,000. And as of Dec. 31, 1953, the total amount insured was estimated to be over one hundred and four billion dollars. Behind this was a deposit insurance fund of only 1.39% of that amount, slightly under one-and-a-half billion dollars. (Annual Report, Federal Deposit Insurance Carp., Dec. 31, 1953) Obviously, another panic could cause the whole flimsy structure to topple just as readily as it did in

1933. It is equally obvious, however, that the government would start the printing presses going long before it would allow another panic to cause a collapse of our banking system. In other words, the government would come to the rescue of the Federal Deposit Insurance Corp. by simply printing more money if it was needed to prevent a collapse of the banking structure.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER VI - Part 2: Highlights of Colonial and U.S. History]

It should be clear that the F.D.I.C. does not correct the basic defect in our banking system. It is just another patch designed to make the old system run a little longer -- a patch that gives rise to the still more complicated problem of how to control bank credit so as to prevent a runaway inflation and still preserve a free banking system.

Later in 1933 Roosevelt announced his plans for currency stabilization and the control of credit. The avowed policy of the Administration, he said, was to control or "manage" the volume of credit in an attempt to stabilize the price level in the United States. Since the bankers' control of credit had failed miserably to give the country any degree of stability, the Administration was going to see if it could do better.

How poorly that job was done can be attested to by all who have suffered from the inflation that has taken place in the last 15 years. The per capita supply of money has been more than doubled, with the inevitable result that a dollar has less than half the value of the dollar Roosevelt hoped to stabilize. And we can't blame the war for our inflation. It is not necessary to inflate the supply of money in order to fight a war. Quite to the contrary, an inflation of the per capita supply of money makes it more difficult to fight a war because of the difficulty of controlling the inflation of wages and prices that results. (While on this subject of war finance, I would like to make the further observation that wars should not be financed by inflation of the supply of money, nor should they be financed by borrowing savings. Why should the savings of American citizens be more sacred than the lives of American citizens? If men can be drafted to fight a war in which they stand to lose their lives, then justice demands that the savings of men should likewise be drafted by direct taxation for war finance. Were such measure taken, we can be assured there would be far less agitation for our country's intervention in the interminable quarrels in Europe and Asia).

By embarking on a course of managed currency in which the government was attempting to control the volume of bank credit, we literally jumped out of the frying pan -- into the fire. It became necessary, in foretelling future trends in business, to watch the Administration and try to predict what it would do. A good example of the uncertainty resulting from this situation occurred in the latter part of 1936 and first part of 1937. The following quotation from the National City Bank Bulletin for February, 1937 explains the cause:

> "The money market has been in a state of expectancy all month, due to recent pointed warnings of possible increases of member bank reserve requirements. Already the period of uncertainty has run on longer than had been anticipated, and the suspense of waiting has tended to heighten the 'jittery' feeling of the market.
>
> "Reflecting these influences, interest rates have firmed slightly, ...
>
> "That short-term money rates are due for some advance from the extreme low points in case reserve requirements are raised does not appear improbable; ...
>
> "It should be borne in mind, also, that an advance of reserve requirements has the effect not only

> of reducing excess reserves, but also of diminishing the deposit expansion possible on the basis of those that remain."

Succeeding developments were told in the issue for March 1937:

> "On January 30 the Federal Reserve Board issued its long expected order raising the percentage of reserves that member banks of the Federal Reserve System must carry against their deposits. The amount of the increase was 33-1/3 per cent, applying to all member banks alike, with the provision -- in order to afford banks ample time for adjustment to the changed conditions -- that half of the increase would go into effect March 1 and the remaining half May 1."

The recession of 1937-38 was in no small measure the inevitable result of this tinkering with the country's prospective supply of money (bank credit). According to Professors Fairchild, Furniss, and Buck of Yale University:

> "...the Administration has confessed that the increase in required reserves in the spring of 1937 was too hard on the banks, forcing them to dump government securities, and thus tending to break the market and initiate the depression of 1937-38." (*Elementary Economics*, p. 627)

The government may think it can do better than the banks in controlling credit -- but some day it will be forced to realize that credit is inherently unstable and therefore not amenable to control.

One of the blackest and most shameful chapters in our history was written during the war years. Faced with the problems of financing a war effort of theretofore unparalleled magnitude, our government resorted to borrowing our savings while at the same time drafting our youth to serve in the armed forces. Since when are savings more sacred than lives? Then, to make matters still worse, the government stooped to selling its bonds for imaginary money (deposits which the banking system is privileged to create on its books). The banks bought $90 billion in bonds by the simple process of creating deposits. The banks also lent billions of imaginary dollars to their customers for the purchase of new securities, especially bonds (the interest rates on the loans being less than the yield on the bonds).

Marriner Eccles, Chairman of the Board of Governors of the Federal Reserve System, said in his book *Beckoning Frontiers* that bankers, bond dealers, brokers, insurance companies, and corporations were delighted with the "windfall profits" resulting from the Treasury's method of financing the war. He was fully aware of how inflationary the Treasury practices were, and he was therefore an outspoken critic of the worst abuses resulting from Treasury operations. In fact, he was so outspoken that many people believe he was finally ousted by Truman because of the embarrassment he caused the Administration by implying that it (the Administration) was largely to blame for the inflationary forces that were causing so much trouble after the war. Be that as it may, we are still left with an unsound banking system, an unsound theory of government finance, and the threat of either increasing inflation or the advent of deflation.

The helplessness of our position today was well expressed in an issue of *Fortune* magazine devoted entirely to an analysis of Money (April, 1948, p. 181):

> "....The monetary system of the United States is well designed to abet both inflation and deflation. And one of the few completely safe predictions about the U.S. economy is that it is headed for either inflation or deflation."

To say that our system is "well designed to abet both inflation and deflation" is to level one of the severest criticisms that could be leveled against the system. And the statement is perfectly valid. Among banking theorists this tendency of bank credit to encourage both inflation and deflation is known as perverse elasticity.

Think of it! It is "completely safe" to predict that we are headed for either inflation or deflation! Either people with fixed incomes are going to continue to be squeezed harder and harder with higher prices, or people who have innocently gone into debt when the supply of money was expanded with bank credit will lose their homes and businesses because of their inability to repay loans when there is a contraction of bank credit. A tremendous amount of injustice will be done either way.

Economists today are, in fact, split into two groups: Those who think inflation will continue and those who think deflation will set in with a vengeance. They do not know whether bank credit will continue expanding -- or whether it will collapse. The sensible thing to do would be to remove the possibility of either occurrence. We should convert our present system of credit banking into a system of deposit banking by converting our billions of dollars of imaginary deposits into actual deposits. We should convert our imaginary money (bank credit) into actual money. And once having stabilized our banking system, we should keep it stable by taking away the banks' privilege of creating imaginary deposits.

Let us take stock now of the situation that faces us. The money plank of the Republican Platform in 1952 promised a restoration of "sound money" freely convertible into gold coin. That's the type of "sound money" that caused all our depressions during the last 300 years. It would be suicidal for us to return to such a system. We would then be in line for another collapse of credit and ensuing depression from which it is doubtful our free institutions could survive.

As might be expected, an ingenious plan has been worked out by those who wish to return to gold convertibility. The plan was explained in an article bearing the title "Currency Convertibility -- Now," by Michael A. Heilperin (*Fortune*, Sept. 1953). Heilperin is fully aware of "the thorny question of central bank reserves." He admits that the reserves of many central banks were inadequate at the time he wrote the article, and he further admits there is no general agreement as to what does constitute "adequate" reserves. He further states that "much depends on the return of public confidence in the various currencies."

There we are again -- face to face with the nemesis of our credit system -- confidence, or should I say lack of confidence? All the experts agree that the system can't work unless we have confidence in it -- but they stubbornly refuse to face the fact that the very nature of the system breeds lack of confidence. The solution now offered to the problem of restoring and maintaining confidence is an extension of the type of thinking that has carried us to ever bigger booms and busts in the past. It is proposed to establish large "convertibility funds" for the purpose of making "convertibility loans" to the central banks of countries with inadequate reserves. The American contribution to this fund would amount to 10 billion dollars!

This is very similar to the thinking that created our Federal Reserve System. It would increase the elasticity of the system more than ever before. If such a plan were put into effect, we would undoubtedly have the biggest boom we've ever had, followed by the worst collapse we've ever had.

When will we face the fact that confidence is bound to be periodically lost in a banking system that has the power to create imaginary money? Are we going to continue following the type of leadership that has given us financial panics for the last 300 years? God grant that we will come to our senses soon enough to avoid another collapse.

Those who today oppose a return to gold convertibility are fully aware of the damage caused by that system in the past. But most of them, in turn, are blissfully unaware of the dangerous threat to our freedom inherent in a continuation of our present type of managed currency. Almost to a man they have made the mistake of blaming gold for the troubles caused by pyramiding credit on top of gold. The result is that they have embraced credit (debt) as a perfectly desirable form of money. They see no danger in the present situation in which the Federal Reserve Board has the power to tighten or ease credit whenever it thinks necessary.

Now it should be obvious that if we're going to use credit as money, then we're better off having our own Federal Reserve Board attempt to control its supply rather than leaving that control up to the automatic forces that were supposed to govern the pre-Depression gold standard. Certainly nobody who understands the situation would want to return to the type of automatic controls that automatically produced a boom and bust every decade. However, as pointed out earlier, there are also grave dangers in continuing with the present system in which the supply of credit is "managed" by the Federal Reserve Board.

It's unfortunate but true that most of the proponents of our present "managed currency" fail to see the threat to our freedom inherent in this system. Those who do see the dangers take the stand that we must resolutely face those dangers because any other course of action would be still more dangerous and an even greater threat to the survival of our free institutions. The late E. A. Goldenweiser, while chief economist of the Federal Reserve Board, ably expressed his opinion on this subject as follows:

> "... most over-all policies have a rather better chance of functioning satisfactorily if they are based on the best available judgment applied to existing and known current conditions. After all, what the advocates of automatic devices propose is the substitution of their own a priori judgment -- unencumbered by responsibility and in advance of the event -- for the judgment of responsible policy makers confronted by the event, presumably in possession of all known facts about it, and willing and able to take appropriate action. Looked at in this way, the proposals lose much of their allurement; they almost fall in the class with attempts to achieve perpetual motion or to discover the philosopher's stone. Energy and ingenuity are better spent in devising means for securing and implementing better judgment in policy makers than in inventing ways to make it unnecessary." (E. A. Goldenweiser, *American Monetary Policy*, p. 77)

Faced with the fact that the automatic gold-credit system failed to perform satisfactorily, Goldenweiser abandoned the idea of having an automatic system and accepted instead the idea that we should rely on the judgment of "policy makers." He cast scorn on attempts to perfect "automatic devices" by saying "they almost fall in the class with attempts to achieve perpetual motion." He had the wisdom to recognize the deficiencies of policy makers because he wanted to secure "better judgment" among them. But he didn't seem to realize that if anything smacks of a search for perpetual motion, that does! After all, men have finite minds. We are capable of inventing and adopting automatic devices of all sorts -- including an automatic money that can regulate our economic system properly. But we are not capable of managing our supply of bank credit in an effort to achieve the same results.

We must remember that money is a standard of value as well as a medium of exchange. To perform its function as a standard of value satisfactorily, the supply or number of dollars must be a known quantity. The "measuring process" by which value is measured would then take place as goods and services interact with this known number of dollars. But if credit is used as money, the supply of credit has to be controlled. "Policy makers" then enter the picture to exercise their quantitative and qualitative controls of the supply of credit. Money ceases to be an objective standard of value the moment a "policy maker" has the power to control the supply in accordance with his ideas of what that supply should be.

> "Well," you may say, "suppose all of us agree that the supply of credit should vary directly as population. Then there would be no arbitrary controls and therefore we'd have just as good a money as under a 100% reserve population standard."

But the fact remains that the volume of credit can't be controlled with that much precision. Suppose, for example, that a contraction of credit commences to take place because of a loss of confidence -- as has happened so often in the past. The government would then have to resort to some means of pump-priming to maintain the required number of credit dollars. That means a further increase in government debt. Wouldn't it be more sensible to have a supply of dollars that couldn't contract? Then the pump-priming would never be necessary.

And, what is more to the point, what excuse is there for continuing to use bank credit as money if we agree that we do not want an elastic supply of money? It will be remembered that our unsound system of credit banking was originally justified on the grounds that we needed "elasticity." If we come to our senses sufficiently to recognize that we do not need elasticity, then shouldn't we remove the elastic element of our monetary system (bank credit)?

Let us review some of the statements of well-known writers about our banking system. The National City Bank Bulletin has always been considered a publication of sound thinking. So it is interesting to analyze the logic in the following quotation from the Bulletin for August 1936. (In that year an increase of reserve requirements took place. The Bulletin is commenting on the effect that this increase of reserve requirements would have on general credit conditions):

> "In estimating the effects of the new regulation upon the credit situation, the fact should not be overlooked that not only will the excess reserves be reduced but the ratio of possible expansion on the basis of those that remain will also be less. Under the present rules requiring average reserves of about 8 per cent (taking account of both time and demand deposits and all classes of banks), the ratio of expansion of deposits to reserves, in normal times when funds have been in demand, has been in the neighborhood of 12 to 1. Under the new rules, with reserves averaging

> close to 12 per cent, the theoretical expansion will be nearer to 8 to 1. *In other words, increase or decreases in reserves, whether due to gold movements or other causes, will tend to be less productive of violent fluctuations in deposits than before. This should be an influence making for more stable credit conditions*." (p. 114) (Italics added)

In the above quotation, the National City Bank of New York is logically pointing out that an increase in reserve requirements "should be an influence making for more stable credit conditions," and therefore a more stable money market. If this line of reasoning (which is perfectly sound) were carried to its logical conclusion, a system of deposit banking with a 100% reserve behind all checking accounts should give us greater monetary stability than we have ever had. But rarely can you get a banker to carry this line of reasoning to its logical conclusion!

Another brilliant expose of the instability of credit banking is contained in the book Banking and the Business Cycle by Phillips, McManus, and Nelson. These men are all highly respected banking theorists in this country. Their observations on the effect that increasing elasticity has had on the business cycle are well expressed in the following quotations:

> "The central thesis of the volume is that the Great Depression and the feverish activity of the immediately preceding years were notably bank credit phenomena. The markedly oscillatory movements of the economic pendulum in the United States during the 1920s and early 1930s are attributable to forces resident in central banking. But for the superimposition of the Federal Reserve Banks upon our commercial banking structure, the amplitude of the cycle in question would have been greatly restricted." (p. 4)
>
> "The principal and immediate effect of the institution of this new system was to economize reserves -- that is, to enable a given foundation of gold to support a much larger superstructure of credit than was previously possible." (Ibid., p. 22)
>
> "Hence it is apparent that central banking is inherently inflationistic, at least during the period following its introduction, on account of the greater expansion of credit it makes possible on a given amount of reserves." (Ibid., p. 25)
>
> "It follows, then, that the height of the recent boom and the depth of the depression are fundamentally the outcome of Federal Reserve credit expansion. The recent cycle may therefore properly be designated a central banking phenomenon. The exaggerated character of the last boom and slump is understandable only in the light of the superimposition of a central banking system upon our former system." (Ibid., p. 140)

The above conclusions appear justified. These banking theorists apparently agree with the general principle that the amplitude of the "business cycle" is proportional to the volume of credit on a given base of reserves. We should conclude, therefore, that the cycle could be reduced to a minimum by adopting deposit banking and abandoning credit banking completely.

But no, their conclusion was quite different:

> "The ideal aim of credit policy is, simply, that *the rate of credit growth should be stabilized*, so that the growth of credit proceeds at the same rate as the growth of population. .... As population increases, the amount of circulating media should increase 'pari-passu' in order to accommodate in as frictionless a manner as possible the increase in total transactions engaged in by a growing number of people." (p. 202)
>
> "The Federal Reserve Board, with its control over member bank reserves through the rediscount rate and open-market operations, is already in large measure adequately implemented for the task of regulating the supply of credit; ..." (p. 210)

Phillips and his collaborators believe that our medium of exchange should increase directly with our population. This is, of course, a very sound principle, as we have already seen. Unfortunately, however, they do not realize the futility of attempting to achieve that goal while using bank credit as money. It would be quite a simple matter, if we had deposit banking, to have the volume of money maintain a fixed relationship to our population. But contrary to their belief, the Federal Reserve Board can not regulate the supply of credit with any degree of precision within the framework of a free banking system. Is it not apparent, from the very nature of bank credit, that it is not amenable to control? Is it not clear that panics will upset the best laid plans as long as banks operate on fractional reserves? And even supposing panics could somehow be eliminated, how are we to control the activities of 15,000 commercial banks throughout the country without endangering the survival of a free banking system and free capital market?

We should realize the full implications of the following statement made by Marriner S. Eccles:

> "Credit must primarily be controlled at the source of its creation, the banking system. This cannot be done on a basis of voluntary agreements in a competitive business involving fifteen thousand banks. There must be adequate powers in the Federal Reserve System to bring about the needed restraint on the part of banks as well as on the part of borrowers." (*Beckoning Frontiers*, p. 473)

Eccles is very good at drawing logical conclusions from a system that makes the mistake of using bank credit as money. He realizes that the control of the supply of money is a Congressional power that Congress has delegated to the Federal Reserve System. Therefore, if we use bank credit as money, the Federal Reserve System must have the power to control the banking system. But I'm afraid Eccles doesn't appreciate the extent of the controls that would be required. Any precise control of bank credit will eventually necessitate the abandonment of a free banking system.

One advocate of our present managed currency -- likewise unaware of the threat to our free banking system -- tried to minimize the dangers of a government control of credit by saying: "It's better for us to control money than for money to control us." But what he overlooked is that the power to control the supply of money is the power to control us. That is the basic reason why the government and the banking system both want that power. But do we wish our government or our banking system -- no matter how altruistic either may be -- to have the power to control or regulate us by altering the supply of money in accordance with their ideas of what that supply should be?

The only way we can preserve our freedom is to have the supply of money free from the arbitrary control of all private or public interests. And the way to obtain that objective is to convert our credit banking system into a deposit banking system, and amend our Constitution so that it states what our per capita supply of money should be. Then, and then only, will we have the twin blessings of a free banking system and a supply of money free from arbitrary controls of private or public groups.

On July 19, 1954, Eccles addressed the opening meeting of the fortieth International Consumer Credit Conference in San Francisco. Among other things, he said:

> "We have never had in the history of this or any other country a period of prosperity without an expansion of debt, whether public or private, or both. Conversely, we have never had a period of depression without a contraction of debt, either public or private, or both." (*San Francisco Examiner*, July 20, 1954, p. 28)

Now nobody can successfully dispute the truthfulness of that statement. Our money is debt (bank credit). Obviously, therefore, prosperity and depression have always been linked to an expansion and contraction of debt. And that leads us to the conclusion that we must continue having an expansion of debt in order to have an expanding prosperity!

But common sense tells us that something is wrong with the premise of an argument whose logical conclusion is that we need an ever-growing volume of debt. And the thing that is wrong, of course, is that we're using bank credit as money. If our supply of money were independent of debt, prosperity would no longer be dependent upon an expansion of debt.

Eccles also made this statement:

> "In a dynamic economy like ours, we can no more put a ceiling on the supply of money than we can put a ceiling on production and employment." (*San Francisco Examiner*, 7/20/54, p. 28)

A person who has understood the ideas contained in this book would answer Eccles as follows:

> "In a dynamic economy like ours, if we don't put a ceiling on the supply of money by stabilizing the supply of money per capita, we shall continue having alternate periods of boom and depression."

It should be clear that we must set precise limits to our supply of money, because a unit of money is our standard of value.

Another conference speaker, Paul M. Millians, Vice President of Commercial Credit Company, made the following statement:

> "Most of the seventeen major depressions in American history have been money panics. .... They were marked by a scramble of bank depositors to withdraw funds; restricted deposits; restricted credit; forced liquidation of bank loans; and forced liquidation of commodities. With Federal Deposit Insurance and other safeguards, plus a sound Federal Treasury, it is inconceivable that such 'ghastly' financial disorder can happen again." (*San Francisco Examiner*, July 20, 1951, p. 28)

Although we may have solved the problem of panics -- purely by subterfuge, however -- it should be evident that we are now faced with the problem of preventing inflation. And although panics are "ghastly," the financial and economic disorders that result from inflation are still more ghastly.

The Cleveland Trust Company's "Business Bulletin" dated July 16, 1954 contained the following statement:

> "The ideal of 'promoting growth and stability in the economy' is praiseworthy because it implies prevention of both deflation and inflation. Our present anxiety to forestall a serious deflation, like that of the 1930s, should not blind us to the possibility of renewed inflation later on. History teaches us that when carried to an extreme, inflation can be even more devastating than deflation. An economy geared to perpetually rising prices would involve the hazard of that extreme. *Long-range governmental policies, therefore, should steer a middle course between the perils of inflation and deflation*." (Italics added)

The essence of this advice is that somehow we should try to make our gold-credit system -- which is inherently unstable and known for its perverse elasticity -- work in such a way that we get neither inflation nor deflation. It just cannot be done within the framework of a free economic system.

You may wonder what bankers have to say about the explanation of the business cycle given in this book. Although a banker will usually acknowledge that a credit banking system aggravates the business cycle, he will deny that it is the cause of the cycle. He will deny that any of the large manufacturers curtail production at the height of a boom because of a loss of confidence in the banking system.

Now even if there were no written evidence to support my views, it would still be preposterous to assume that our big companies are unaware of the instability of the gold-credit mechanism. As it is, however, there is written evidence. Bradford S. Smith, Economist for United States Steel Corporation, delivered a speech in 1947, bearing the title, "Roots and Fruits of Boom." In this speech he gave the following penetrating analysis of money:

> "...the economics of money is obscure to most people. Yet matters pertaining to money must be comprehended if there is to be judicious thinking about causes, controls and consequences of inflationary boom. In fact, were it my habit to indulge in admonitions, I would say that the

> American people had better find out about money -- and quick!
>
> "That which people use to pay for things they buy consists of their coin and paper currency in hand and their check deposits in banks. These add up to a certain number of dollars which is what I call the money supply. This is the item usually tabulated in monetary statistics under the caption, 'Total demand deposits adjusted and currency outside banks.' Most people come into possession of some of this money only by selling their competitively acceptable goods or services to others. The supplying of goods and services is their method of acquiring dollars. If that were always true for everybody, America would be rid for always of inflationary booms and their reactionary busts. To the extent that this is not true America has a boom-and-bust money system.
>
> "Thus suppose no one could get money to spend except by concurrently selling goods or services. Then it follows that the money each one gets to spend in markets equals the goods or services he supplies to markets. Hence the total of goods and services going to markets is matched by the total money going to markets. There is balance. This is true even if some lend or give their money to others, for the lender takes himself out of the markets to the extent that his loan enables the borrower to enter them. Money would then be a medium of exchange for goods and services -- and that only. *It would also meet my personal definition of 'honest' money because each person could then be sure that with the money he got from selling his services or goods he could obtain, over time-spans, equivalent goods and services of others*. The buying power of his money could not be taken away from him during the periods he held it; and money contracted to be received in the future would represent buying power over goods approximately equivalent to that currently relinquished in entering into the contract. *This would be the kind of money that gold would be in a community in which payments were exclusively made by its physical transfer and the total supply of which could only be increased very slowly, if at all, by its mining*." (Italics added)
>
> "In this sort of situation the prices and costs of some goods and services in markets could go up while others went down reflecting shifts in customer preferences, inducing corresponding shifts in production. These would be desirable. They would represent the competitive markets efficiently at work, keeping production continuously and closely adjusted to the shifting demands of a nation at work and progressing. Prices in general could even trend gradually downward, reflecting technical achievement in the efficiency of production.
>
> "The roots of inflationary boom are public ignorance about or indifference to the meaning of honest money and the means of maintaining it; the fruits of boom are injustice, wasted resources and economic maladjustment while it lasts, and deflationary depression, unemployment and social unrest when it is over."

Now it should be obvious that the "physical transfer" of gold is not essential to the establishment of "honest money" as envisaged by Smith. The same objective would be reached if all paper money -- notes and checks -- were made fully representative of gold and kept fully representative of gold at all times. In other words, a deposit banking system in which the total supply of money increased very slowly would provide us with an "honest" money as described by Smith. (We shall have occasion to discuss Smith's views further in the next chapter.)

History has shown quite conclusively that credit banking would have died a natural death in its infancy -- had it not been for government protection and the propagation of a mass of illogical theory. The public has become so confused that they now look upon the system as the "spring from which all blessings flow," "the handmaiden of industry and commerce," and "the creator of our modern economic society." In a very real sense, our banking system actually is the creator of modern economic society. Our society could not exist without an adequate supply of money. But our banking system -- because of its inherent instability -- is also the creator of all that goes with our modern economic system: Unemployment, poverty-in-the-midst-of-plenty, and strife between capital and labor. We could have had the same progress without the attendant collapses if we had only been building with a money that would not collapse.

We have been using an elastic money -- a money that expands and contracts. Our entire price structure, which is supposed to regulate production, was determined by a supply of money that was very unstable. No wonder free enterprise appears to have failed and is being challenged on the grounds that it cannot regulate itself! Private enterprise most certainly cannot regulate itself so long as it uses an unreliable money, an "elastic" dollar, a "rubber" dollar.

The very basis of a free economic system -- upon which political freedom depends -- is slowly being destroyed. A free system cannot regulate itself unless the forces of supply and demand are allowed to operate on prices. But these forces are cruel and merciless, in a market that uses a collapsible money -- so much so that all sorts of protective devices -- all of which thwart the law of supply and demand -- are now being used. Labor unions in particular are regarded as necessary to protect labor from exploitation by management. We lose sight of the fact that both labor and management are exploited by bank credit. It is the expansion of bank credit that prevents prices from gradually falling as costs of production decline -- thereby robbing labor of an increase in real wages. And it is the actual or anticipated contraction of bank credit that causes most business failures, unemployment and consequent grinding down of wage levels.

We are in the midst of a bitter battle between management and labor. Each points an accusing finger at the other. Each blames the other for high prices. Actually, however, they are both victims of a trebling of our supply of money since before the war.

If bank credit were not used, and the per capita supply of money were stabilized, the continuous competitive bid of management for available labor would force wages to the highest possible level consistent with a smoothly functioning economy. A stable volume of money would force prices down as costs go down. Consequently, labor's real wages would steadily increase. Let us hope that both labor and management will recognize the primary cause of their troubles and join forces to help bring about a much-needed stable banking system and stable supply of money.

The consideration given above -- plus 300 years of disappointing experience with the system -- should convince us that bank credit should no longer be used as money. We must have a medium of exchange that coincides with our standard of value if we want stability. In other words, we must convert our credit banking system into a deposit banking system. Let the government take over its proper function of providing us with an adequate supply of money; and let the banking system take over its proper function of warehousing or safeguarding that money, facilitating the transfer of titles to that money (checks), and lending money that has been placed with it for that purpose.

At this point I would like to tell you what some of my "management-minded" friends say to me. Their attitude may be summed up as follows:

> "What are you worried about? We don't need to fear panics anymore. Domestic gold-convertibility will not be restored. The F.D.I.C. will be supported by the government in the event of an emergency. So why all the fuss?"

Those who have read and understood the message in this book will answer as follows:

> "It's not just a question of solving the problem of bank panics. Sure, we may have solved that problem -- but our solution to the problem was not the correct one. And because we failed to apply the correct remedy, we have a government that now gulps down over 25% of our national income -- a government that feels it has the responsibility of providing us with 'cradle-to-the-grave' security -- a government that blithely goes further and further into debt on the grounds that it's necessary -- a government that believes it is necessary to redistribute the national income in order to keep things going.
>
> "You may like these things -- or at least approve of them even if you don't like them -- because you think they are necessary. You do not have the faith in freedom that we have. You think the cause of our troubles was inherent in our free system. But we deny that. We say that there is no sound reason for believing as you do and that there are many sound reasons for believing as we do. You are apparently unconcerned over the growth of big government. You seem to look upon the government as a benevolent thing that will take care of all of us. We look upon it as an octopus that will strangle us if we give it a chance."

And we don't need to argue that last point. Look at history. The founding fathers of our republic were well aware of past history. They did a wonderful job of setting up a government that would be our servant rather than our master. But we have gone a long way toward destroying the type of government they set up. And unless we awaken ourselves to the dangers that confront us, and correctly diagnose the cause of our ills, we will finish the job of destroying one of the noblest attempts to free men from tyrannical government the world has ever seen.

Many arguments were given in Chapter III for the abandonment of credit banking. But the main argument -- the one that should be constantly kept in mind -- can be given in the form of a syllogism, as follows:

> 1. Price is a measurement of value and therefore should always be in terms of the legal measure or standard of value.
>
> 2. Prices are always in terms of the medium of exchange.
>
> 3. Therefore the medium of exchange must be made to coincide and be fully representative of the legal standard of value.

Once the above argument is thoroughly understood, the necessity for deposit banking becomes self-evident. The only way our medium of exchange can be made to coincide with our standard of value is to convert our credit banking system into a deposit banking system.

The principle of deposit banking -- or 100% reserve behind checking amounts -- was rediscovered by many economists following the Panic of 1933. Many different writers during the past two hundred years have suggested that we should return to that type of banking which was practiced by the Bank of Amsterdam prior to its corruption. But it wasn't until after the last big panic that a definite body of opinion began forming -- a definite school of thought. And in the 1940s the late Professor Irving Fisher -- in cooperation with then-Congressman Jerry Voorhis -- worked diligently to bring this matter before Congress. Fisher conducted a poll among all members of the American Economic Association to determine how many approved of the 100% reserve principle as a means of helping to prevent inflation and deflation. I do not know the final results of that poll -- nor whether it was ever completed. But in the process of completing the poll, Fisher sent out a list of two hundred and seventy-eight prominent economists who had already signified their approval.

The introduction and first section of Professor Fisher's list read as follows:

> "Here is a partial list of economists who have signified their general approval of a 100% reserve behind checking accounts as a help toward preventing inflation and deflation.
>
> "After the addition of other names which, I trust, will come from this final appeal, the complete list will be handed to Congressman Jerry Voorhis of California, with the request that he have it printed in the Congressional Record and given to the press. Meanwhile, of course, the list below is not to be made public. At the present writing the total number of signers of economists and economic students represented in the list is over 1100, 96 of whom have specified reservations.
>
> "Out of the 1100 names only 278 are given here. The selection was made (by some colleagues better acquainted than I with 'Who's who'), chiefly for the weight the names are likely to carry with the prospective signers now being solicited. It is noteworthy that a number of leading economists who originally declined to sign -- or even expressed disapproval -- have reconsidered and finally expressed approval."

Fisher then listed those who had already written on the subject or otherwise had given it special attention as follows: (the notes following each name are Professor Fisher's)

> "Frederick Soddy, English physicist, a Nobel Prize winner, believed to have been the first to discover the 100% principle (1926).
>
> "Henry C. Simons, and several other economists of Chicago University (including Aaron Director, Garfield V. Cox, Paul H. Douglas, A. G. Hart, Frank H. Knight, Lloyd W. Mints and

the late Henry Schultz), whose originally anonymous memorandum of 1933 announcing their independent discovery of the principle, was my first introduction to the plan, as a practicable one.

"Charles R. Whittlesey, of the University of Pennsylvania, who has written on the subject.

"Frank D. Graham of Princeton, who also has written on the subject.

"The late Professor John R. Commons of the University of Wisconsin, who with Paul H. Douglas (already mentioned), Professor Frank K. Graham (already mentioned), Professor Earl J. Hamilton, now of Northwestern University, Professor Willford I. King of New York University, Professor C. R. Whittlesey (already mentioned), and myself made, before the war, the first appeal to economists for support of the 100% principle.

"Professor James W. Angell of Columbia University whose able and searching criticisms of the first edition of my 100% Money led to important improvements in the details of the plan as there proposed -- but without affecting the essentials, agreement on which is here sought.

"Richard A. Lester, now Associate Professor at Princeton University, who also has written on the subject.

"Robert H. Hemphill, sometime credit manager of the Federal Reserve Bank of Atlanta, another independent discoverer.

"Lauchlin Currie, still another independent discoverer, former aide of Governor Eccles of the Federal Reserve Board, afterward of President Roosevelt, and now President of the Investment Industries Corp.

"F. R. von Windegger, President of the Plaza Bank of St. Louis, who took the trouble to go to a bankers' meeting in Minneapolis for the sole purpose of urging the conferees to read my *100% Money*.

"W. L. Gregory, President of the Eaton-Taylor Trust Company of St. Louis, who wrote an article in a bankers' magazine in favor of the plan.

"Alexander Efron, vice-president of the National Safety Bank & Trust Company of New York City and inventor of the CheckMaster Plan (i.e., 'pay as you go' or 'no minimum balance' plan) which has been extensively imitated.

"Robert D. Kent, late president of the Merchants Bank of Passaic, N.J.

"Ex-Senator Robert L. Owen, one of the authors of the Glass-Owen Bill which became the Federal Reserve Act.

"Judge T. Alan Goldsborough, formerly member of Congress."

Then followed a list of 253 prominent men -- mostly professors of economics -- who had given their approval of the 100% reserve principle without reservation.

I asked Fisher, in 1947, for permission to use this list to support the publication of my book. But at that time he requested me not to. He wished to first complete the list and have it printed in the Congressional Record. Now that Voorhis is no longer in Congress (a great loss to this country) and Fisher has passed away (another great loss to this country), I see no harm in making this information public -- particularly the names of those given above.

A word or two should be said about Fisher's specific proposal for monetary reform known as the "Commodity Standard," or "Index-number Standard." After converting our credit banks to deposit banks, Fisher proposed to regulate the supply of money in an effort to maintain a constant price index. As prices rose above a certain point, the government was to reduce the supply of money. As prices fell below that point, the government was to increase the supply of money.

There is great danger in such a proposal -- to say nothing of its being unscientific. As pointed out earlier, one of the principal functions of money is to serve as a standard of value. The purpose of having a standard of value is to get valid measurements (prices). So it wouldn't be logical to turn around and use the measurements (prices) as a basis for determining the validity of the standard. Our Bureau of Weights and Measures wouldn't be justified in continually changing the dimensions of our unit of weight in order to make certain objects weigh as much as the government thought they should. And the same goes for our standard of value. Nobody knows what the prices of various commodities should be, nor what the prices of all commodities should be. That is why we need a standard of value.

The important attribute of a good money is the constancy of its supply relative to population. It is an actual or anticipated change in the per capita supply of money that causes trade to fluctuate. One of the reasons credit banking is so unsound is that it causes the per capita supply of money to be highly unstable. Fisher was absolutely correct, therefore, in his insistence that we have 100% reserves behind checking accounts, but is subject to question when he proposed to have the supply of money expanded and contracted as a specified price index falls or rises. The supply of money would be highly unstable under such a system, and the business world would therefore still find itself obligated to regulate its affairs according to an unstable money market rather than according to basic economic conditions.

Fisher's proposal to stabilize the price level is similar to many other proposals for monetary reform in that it is not based entirely on the fundamental weakness of our monetary system but rather on a result of that basic weakness. The fundamental weakness of our monetary system is that it gives us a highly unstable supply of money per capita. As a result of that weakness, we have a fluctuating price level. If we eliminate the basic weakness by stabilizing our per capita supply of money, then the evils resulting from the use of unstable money -- one of which is a fluctuating price level -- should no longer bother us.

I presented the above arguments to Professor Fisher before his untimely death and suggested that possibly it would be sounder to have the supply of money changed only as our population changed. His reply was as follows:

> "...The truth is that I, like you, prefer the per capita money allowance to the index number as nearer an ideal standard.
>
> "However, I found so little response and such an entire absence of precedents that in order to get anything done, I think we should first press for the index number standard. This was officially recognized by Sweden and will be far easier to put over than a per capita standard." (Letter dated February 20, 1947).

With all due respect to Professor Fisher, I think that exactly the opposite is true. Considering all factors, it should be more feasible politically to adopt a "population standard" than a "commodity standard." A commodity standard would be subject to manipulation by whoever has the power to determine the component parts of a price index. A population standard could not be so easily manipulated. Census figures would be the guide.

However, in the last analysis, a question of this sort should not be settled on the basis of politics but rather on the basis of sound economics. And on this basis Professor Fisher agreed that a population standard would be superior.

Although Fisher's proposal to vary the supply of money in an attempt to maintain a stable price index is very unsound, nevertheless it should be pointed out that our present Administration's effort to control the volume of credit in such a way as to promote "full employment" is even more unsound. If we're going to continue with our present "managed currency," then we should convert our credit banking system into a deposit banking system because it is far easier to exercise a precise control of the supply of money under a deposit banking system.

As stated before, it is very unsound to let the government alter the supply of money in an effort to achieve a stable price level, or "full employment," or any other objective other than a stable supply of money per capita. But if we fail to see the wisdom of having a precise number of dollars per capita, -- if we fail to see that the proper functioning of a system of private enterprise necessitates our having a constant per capita supply of money that can be relied upon by those who are expected to take business risks and create jobs, -- if we continue with the naive belief that the government can somehow promote business stability by juggling the supply of money per capita, then we should at least recognize the fact that the government's juggling will be less productive of instability if we have a system of 100% reserves rather than our present system of credit banking. This point should be self-evident to anyone acquainted with the complex forces that determine the supply of money in a system of credit banking. This is the point that so many members of the American Economic Association saw clearly when they notified Fisher of their approval of the 100% reserve idea.

The wide acceptance of Fisher's proposal for 100% reserves (not his proposal for the commodity standard) is understandable when you bear in mind that the perverse elasticity inherent in credit banking is a generally accepted fact. What is not so easy to understand is why there are not more economists and students of economics in favor of 100% reserve banking. The explanation, I believe, lies in the fact that although most people will admit that credit banking gives our money an element of perverse elasticity, nevertheless they aren't just sure of how to convert our present system into a system of deposit banking. And also they are not sure of what should determine the supply of money after all bank credit is converted into 100% money. The purpose of Chapter VIII is to clarify these points. But before discussing the details of banking reform, I would like to review a recent publication of the National Industrial Conference Board bearing the title: "Shall We Return To A Gold Standard -- Now?"

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER VII: "Shall We Return To A Gold Standard -- Now?"]

In March, 1954, the National Industrial Conference Board, Inc. issued a publication bearing the title of this chapter. It was a transcript of a round-table discussion on that subject by the members of the Economic Forum of the National Industrial Conference Board who met with several guests -- all recognized experts in this field. Those attending were:

- Murray Shields (Discussion Leader), Vice-President and Economist, Bank of the Manhattan Co.
- The Conference Board Economic Forum consisting of:
  Martin R. Gainsbrugh, Chief Economist, National Industrial
  Conference Board
  Edwin B. George, Economist, Dun & Bradstreet, Inc.
  O. Glenn Saxon, Professor of Economics, Yale University
  Bradford B. Smith, Economist, United States Steel Corporation
  Rufus S. Tucker, Economist, General Motors Corporation

Guests:

- James Washington Bell, Professor of Economics, Northwestern University
- Edward M. Bernstein, Director of Research, International Monetary Fund
- W. J. Busschau, Manager, New Consolidated Gold Fields, Ltd, South Africa
- Lester V. Chandler, Professor of Economics, Princeton University
- Philip Cortney, President, Coty, Inc.
- Henry Hazlitt, Editor, The Freeman
- Miroslav A. Kriz, Chief, Foreign Research Division, Research Department, Federal Reserve Bank of New York
- Philip M. McKenna, President, Kennametal Inc.
- Donald H. McLaughlin, President, Homestake Mining Company
- John S. Sinclair, President, National Industrial Conference Board

Everyone concerned with the future of this country should get that publication and read it carefully. It is full of valuable information and powerful arguments supporting divergent views concerning the restoration of domestic gold convertibility in the United States.

If you have digested the theories already given in the preceding pages of this book, you will find yourself able to reconcile what would otherwise be irreconcilable differences between these experts. I shall quote briefly from that publication to bear this out.

The two featured speakers were Mr. Busschau and Mr. Kriz. Mr. Busschau is the manager of a gold-mining company -- which naturally means he has an axe to grind. Nevertheless, his talk was brilliant; and in many cases, his logic was far superior to that of some of the others present.

His conception of the international gold standard was expressed as follows:

> "I would say that we would have an international gold standard in the world as a whole when we have a group of nations among whom there is complete convertibility internally and externally. The amount of credit in each country would have to be managed with reference to the gold reserves held. That imposes a restriction on the creation of credit. That in present circumstances would pose difficulties." (p. 12)
>
> "I accept the Keynesian rhetoric that this is 'barbarous' in the sense that other things in modern use also are. But it is the historical answer. If you are on a commodity-money standard, then you have to manage your credit with your eye on the commodity money. When there is in this sense a limit, then the volume of credit and prices have to readjust themselves to that." (p. 13)

I admire Mr. Busschau's frankness in agreeing with the late Lord Keynes that it is "barbarous" to have the amount of credit in a country regulated by the amount of gold reserves. Some idea of how barbarous that system can be was indicated by Mr. Bernstein when he gave the following historical facts:

> "The steady depression in England and the United States from 1815 to 1822 was caused by the struggle to restore specie payments after the wartime inflation of the preceding years. No country ever worked so hard to reestablish the prewar parity of its currency as the United States did after the Civil War. In the course of fourteen years, the dollar was brought back from the equivalent of 35 cents in gold to the full 100 cents in gold. *But it took an enormous amount of deflation to accomplish this; and it involved the most prolonged, if not the most severe, depression in our history*. The big slump in the United Kingdom after the First World War was not that which followed the collapse of 1929-1931 but the deflation that began in 1920 in order to restore sterling to its historical parity." (p. 76) (Italics added)

But although the system is barbarous, I thoroughly agree with Mr. Busschau that if credit is to be pyramided on gold, then the volume of credit must be regulated by the amount of gold reserves. That is the only way the international gold standard can be made to work. The way to cut through this tangle, i.e., the way we can stop being barbarous and still have a monetary system that will work satisfactorily is to stop pyramiding credit on gold (or whatever is used in lieu of gold).

Busschau's contention that this barbarous system "is the historical answer" is subject to question. This system is so barbarous, and has broken down so often, that we have repeatedly departed from the system and adopted less barbarous practices. The only reason we keep returning to this system is because the general public is not aware of how barbarous it is. And the reason for this is that the evils resulting from this barbarous system are still erroneously blamed on private enterprise, the profit system, overproduction, sun-spots, and every other conceivable cause but the right one.

Mr. Kriz told how damaging the gold standard can be if internal convertibility is permitted:

> "...while the internal gold convertibility of the dollar in no way restrained the inflationary pressures of the Twenties, it contributed to the collapse of our monetary system in the early Thirties. The root of the trouble was that the necessity for the Federal Reserve Banks to be prepared for an internal drain on gold -- as well as the drain itself once it had gained momentum in 1933 -- exposed our economy to a drastic and undesirable deflation." (p. 23)

Mr. Saxon took issue with Mr. Kriz as follows:

> "...There was no inflation of commodity prices for they were falling or stabilized in this period.

> Had discount rates been raised in 1926 instead of in 1929-1930, there would have been no stock inflation of the degree we experienced. Nor did the convertibility of the dollar contribute to the 'collapse of our monetary system of the early Thirties,' as Mr. Kriz claims. As I stated earlier, that collapse was due to the collapse of the international gold standard abroad in 1931-32, not by our own convertibility." (footnote, p. 23)

The statement that there was no inflation of commodity prices during the 1920s is not true unless the word "inflation" is defined improperly. There was a terrific inflation of bank credit during this period, as Mr. Kriz pointed out, and prices were therefore very much inflated in terms of gold. That is why there was such a severe deflation when the collapse came.

It is nothing short of a complete distortion of the truth to say, "the convertibility of the dollar did not contribute to the collapse of our monetary system in the early Thirties." And the effort to place the blame for that collapse on the collapse of the international gold standard abroad in 1931-32, rather than on our own convertibility, can best be answered as follows: The international gold credit system is like a giant balloon, with many different fingers representing the monetary systems of each country. When the balloon is blown up to the extent that it was in 1928, it doesn't take much to prick the bubble. Whether the initial loss of confidence first has its effect in this country or abroad has absolutely no significance whatsoever. What is of significance is that once the loss of confidence occurs, the deflation commences, and all parts of the balloon are doomed to suffer from the deflation. Anyone who understands the operation of the gold standard knows that a collapse of gold-credit in one country is expected to have its repercussions in all other countries that use gold-credit. And the extent of the repercussion is greatly magnified, as Mr. Kriz pointed out, in those countries that have internal gold convertibility.

This argument about where the collapse first occurred reminds me of the gentleman who read of the events leading up to the National Bank Holiday in 1933 and made the comment: "If only that bank in Detroit could have received a large cash loan, there would have been no trouble in Detroit and no Bank Moratorium in Michigan and therefore no other Bank Moratoriums and no Bank Holiday." It's like a child building a house of cards and lamenting the fact that one of the cards slipped and caused all the others to come tumbling down! Hadn't we better consider building a structure that is more permanent? Shouldn't we have a money and banking system that can be relied upon to stand firm regardless of what happens in other countries?

Mr. Kriz took issue with Mr. Busschau's contention that gold is the only international money:

> "Both common observation and economic study suggest, on the contrary, that money is generally defined by its acceptability. That, in turn, is not necessarily related to gold as the ultimate means of payment. Even under the traditional gold standard, final payments in international trade were made largely in sterling. Today, it is the United States dollar that is widely sought, not for conversion into gold but as an international means of exchange.... *The international role of gold thus derives mainly from its convertibility into dollars, and not the other way round. In any event, foreign monetary authorities are holding a very large portion of their gold and dollar reserves in the form of dollars*." (pp. 27-28)

The following statement by Mr. Kriz should settle once and for all the relative importance of gold and the U.S. dollar as a standard of value in terms of which prices are expressed:

> "To my mind, the long-term charts where gold output and stocks are elaborately related to commodity prices bear a greater resemblance to astrology than to central banking. There is no scientific proof of any direct and immediate relationship between gold and commodity prices in the complex real world." (p. 28) (Italics added)

The reason there is no connection between gold and commodity prices is that prices are not in terms of gold. Nor were prices in terms of gold prior to 1934, when we were on a full gold standard. Prices are always a result of the interaction of the medium of exchange with goods and services offered for it. Therefore the only way prices could be in terms of gold would be if the medium of exchange were fully representative of gold, i.e., backed dollar for dollar by gold.

But if there is no direct connection between prices and our legal standard of value (gold), then something is radically wrong! Imagine an engineer saying: "There is no scientific proof of any direct and immediate relationship between a yardstick and all our measurements of length that are supposed to be expressed in terms of a yardstick." An engineering mind quickly sees the absurdity of such a situation. And indeed, it was an engineering mind that pointed out that something ought to be done about it. Mr. McLaughlin, President of Homestake Mining Co., hit the nail squarely on the head when he said:

> "If I were a patient laid out on this table and this group of eminent doctors were around me ready to operate, their lack of agreement would scare me to death. And this gives me a little courage, as a mere engineer, to speak up. It seems to me that, after all, there is one fundamental question: Is gold a standard? If it is a standard, it ought to have some persistent value through the years. If we say the paper dollar is a standard and gold has to be adjusted to the paper dollar, why then bother with gold?" (p. 49)

That's the kind of intelligent thinking we need -- and need badly. The paper dollar has been our actual standard of value for over 100 years, in spite of the fact that gold has been our legal standard of value. The proof of this is that prices have been in terms of those paper dollars and not in terms of gold. It is futile to argue otherwise. Obviously, however, Mr. McLaughlin did not intend to reach this conclusion!

Mr. Kriz did not recommend doing away with gold. He still talked in terms of maintaining the existing system whereby the U.S. government buys and sells gold "at a fixed price in transactions with foreign monetary authorities for monetary and other legitimate purposes." (p. 21). And that is what leaves Mr. Kriz in a very illogical position, as pointed out by Mr. Hazlitt:

> "Private citizens, as well as central banks, should be able to demand gold for their notes: American citizens should be able to demand gold as well as foreigners, and should be able to demand this as a right and not a privilege revocable at any time by governmental whim. ....It is a question of giving the poor man, as well as the rich, the right and ability to protect himself by demanding gold whenever he has doubts about the convertibility of his paper money. A gold-bullion standard is merely a rich man's gold standard. Our present central-bank gold-bullion standard is merely a bureaucrat's gold standard." (pp. 81-82)

You can't dispute that argument. Certainly American citizens should have the right to play this game if foreign bankers are to continue having that right.

But we're then faced with the argument presented by Mr. Bernstein (also supported by Mr. Kriz) as follows:

> "Private redemption in gold coin or gold bullion sets up another authority to direct monetary policy in a haphazard way. When the public can redeem money into gold coin and bullion, it is invited to engage in a special type of open-market operation not fundamentally different in its effect on the money and banking situation from the open-market operations of the Federal Reserve System. With gold redemption, the public will be able to increase or decrease the money supply and the reserves of the banking system by taking gold out of and putting it into private hoards. The Federal Reserve authorities may think that banking reserves should be tightened, but they may be unable to offset an influx of gold from private hoards; or they may think that banking reserves should be eased, but they may be unable to offset a flow of gold into private hoards. Private gold redemption can do no good and it can do much harm. It may not necessarily be bad, but it can be very bad most inopportunely. The public is likely to be quite wrong in the timing of its gold operations. I have a feeling that when business is booming and speculative markets are profitable, the public will join in the boom by bringing gold to the monetary authorities and thus ease bank credit. And when business is bad, when the monetary authorities may want to ease bank credit, the public will intensify the difficulties by withdrawing gold through redemption and tighten bank credit. We have had one experience of that kind. It is not wise to put such an instrument for open-market operations in the hands of the public." (pp. 73-74)

The above argument is perfectly sound -- but it leaves a logical-minded person wondering why, if we fear the consequences of domestic convertibility, we should trust foreigners with the power to withdraw gold when we don't trust our own citizens? Several of the gentlemen present raised the foregoing question.

What is the answer? We shouldn't allow anybody to play such a havoc-wreaking game! We shouldn't even have such a game! We ought to abandon the gold-credit system altogether and adopt a monetary system that is tailored to our needs, and that would give us a stable unit of value. And again it was the engineering mind that suggested this same conclusion. Mr. McLaughlin says:

> "The logic of the arguments so well presented by Dr. Kriz seems to lead to this conclusion. Why bother with gold at all if its use must be so restricted? Why not rely exclusively on a dollar so managed by 'responsible and competent men' that it will serve whatever purposes they happen to feel are best for us?" (p. 56)

The logic of Mr. McLaughlin's position is unassailable. (But as President of a large gold mining company, I'm sure he didn't mean to present such a devastating argument against gold!) If we allow our banking system to pyramid credit on gold, then we are forced to restrict the use of gold in order to avoid the "barbarous" conditions that would otherwise logically result. And if the use of gold is to be restricted, then we may as well abandon it altogether. However, Mr. McLaughlin has an obvious aversion to having a dollar managed by some government men in accordance with their ideas of what is good for us. Many others share that opinion; I do myself. The law of supply and demand makes it imperative that we have a supply of dollars we can rely upon. We don't want the number of dollars arbitrarily changed by the government -- nor do we want it changed by foreigners or domestic speculator-hoarders who can cause such changes under a gold-credit system by withdrawing gold.

The monetary needs of our country are best known by the business economist. And that is why it was Bradford B. Smith, Economist for U.S. Steel, who came the closest of all those present in suggesting what ought to be done with our monetary system. He first pointed out:

> "If the gold standard in theory has any virtue which commends itself to adoption by mankind, it is that the stability inherent in the accumulated stock of monetary gold presumably lends some stability to the supply of money with which the people do their business." (p. 89)

He then presented a chart showing the ratio of money supply to gold for the period 1895-1954. His conclusions, based on the historical record shown in the chart, were as follows:

> "The chart shows that prior to 1915 there tended to be some stability in the relationship between the total money supply and gold. That stability disappeared with the adoption of the Federal Reserve System.
>
> "The ratio of the money supply to gold ranged from 8.3 in 1920 down to 1.9 in 1940. It is currently about 5.6. That means that the gold standard as practiced over the past forty years in the United States has been interesting but it simply has not yielded the results its theory promises. We thus have a very serious thing to deal with in this country which, on the record, is not to be successfully met by simple return to a predepression gold standard. What is required is development of some sort of mechanism or policy or philosophy or public understanding which will meet the great want of the American people in this area. They want freedom from inflation and deflation, which cannot be secured, on the evidence in the record, by a redemption of dollars in gold." (p. 90)

"... I have over the years asked myself, 'what is it that we want of our money?' *I have gradually concluded that what we want is a considerable degree of inelasticity*, except that money should be able to grow with the country. .... *A very good case could be made for a constant supply of money per capita*. But the record seems to show that with the adoption of the Federal Reserve System under the slogan that we needed an elastic currency, we also adopted a notion that an elastic money supply was a good thing for this country. The record shows that manipulation of our money, in amateurish ways, has made money not the stabilizer that it ought to be, but a magnifier that it should not be. Our records of industrial production and employment show, for example, that the booms have been bigger and the busts worse since its coming." (p. 94) (Italics added)

Basically, what Mr. Smith has pointed out is that the pyramiding of "elastic" credit on "inelastic" gold has destroyed the stability we are supposed to get from the gold standard. And there is no disputing that fact. The strength of Mr. Smith's position is in his realization that the most important thing about money is the stability of its supply -- not the material of which it is composed. And his suggestion that "a very good case could be made for a constant supply of money per capita" indicates that he has a good grasp of the fundamental requisite of an "honest" money for the American people. The only point at which Mr. Smith goes astray in his logic is that after emphasizing the need for an inelastic money, and after pointing out that it was the use of an elastic money that caused our troubles, he then proposes that we continue to use the elastic element of our banking system (bank credit). I realize that the only reason he has done this is that he believes the Federal Reserve Board will somehow be able to control or regulate the amount of bank credit with more precision than they have in the past without endangering our free economic system. But it cannot be done. Any precise control of bank credit is impossible without a tremendous amount of government interference in banking coupled with basically unsound plans for a compensatory budget or pump-priming, etc.

However, if we will combine the views expressed by Mr. Smith in 1947 with the views he expressed before this group in 1953, we will have the logical answer to our monetary problems. His concept of an "honest money" definitely necessitates the adoption of deposit banking. And his suggestion of maintaining a constant number of dollars per capita would give us a money that wouldn't be subject to the whims of the bureaucrats. This is the essence of the reform measure suggested in the next chapter.

Mr. McLaughlin made another pertinent comment regarding gold as follows:

> "If the gold standard is merely a gadget, only of some possible service after monetary and economic stability in the world had been attained by other means, as Dr. Kriz implies, the fabulous investment of some $22 billion that we have made in the metal would seem rather a strange venture." (p. 58)

Our stockpile of gold is the result of man's desperate need for a stable supply of money. It was natural in early times that gold became the most desirable form of money, because its supply was comparatively stable. It was also natural that the use of paper money (notes and checks) supplanted the use of gold as a medium of exchange because it facilitated the process of making payments. But our practice of debasing our legal standard (gold) by allowing our medium of exchange to become diluted with paper money that wasn't fully representative of gold destroyed whatever stability a gold standard could have given us.

It will truly be a strange venture if we decide to continue using that vast gold hoard as a basis for a system of credit banking similar to that which existed prior to the panic of 1933. We have been burned so many times by that system that it seems almost inconceivable that we would be foolish enough to set it in motion once more.

It will be an equally strange venture if we continue our present credit system in which our supply of money (credit) is managed by bureaucrats in accordance with what they think is good for us.

And it would also be a strange venture if we decided to go back to a 100% reserve gold standard -- knowing as we now do that the supply of gold in each country can't be expected to vary directly as the monetary needs of each country.

The obvious thing for us to do is to adopt a money that will satisfy our needs and make it illegal for bankers or bureaucrats to tamper with it. Then we could commence exchanging our vast gold hoard for the raw materials of other countries and benefit at long last from the huge investment we have in the yellow metal.

Now let's consider some of the arguments of Mr. McKenna:

> "I feel very strongly about this. Some of us sit here tonight in the Waldorf and mock the misery of a world bled white. People that I know, women and children, have been robbed. I don't

> regard it in the calm, intellectual manner of Dr. Kriz. I wish I could. I feel that humanity is crucified by managed money and by 'wise and competent men' deciding what shall happen to widow Jones and to the humble inventor who has saved up his money in the hope of doing something with it. I have told this to Donald McLaughlin and he, I think, is dimly aware of my thoughts -- that it is dishonest and cynical to deny to the people of the United States, as if they were second-rate citizens, the right to convert their currency.
>
> "Are we slaves that foreign central bankers can cynically decide whether their central bank is going to draw some more gold, as they have drawn over $1 billion in the last nine months, while American citizens are not afforded an equal choice of the kind of money they may prefer for their individual or company protection? I believe that politically we can enact the gold-coin standard of money and should do so. And the people who haven't felt the pulse of America are going to feel it in no uncertain terms very soon." (pp. 58-59)

What Mr. McKenna is overlooking, of course, is that Mr. Kriz's "calm, intellectual manner" is backed by a wealth of knowledge about central banking practices. Mr. Kriz is fully aware of the extent to which the American people have been "robbed" and "crucified" in the past by the very type of gold convertibility that Mr. McKenna wants. It was the convertible dollar of the 1920s that finally led to the collapse of credit and resulting foreclosures, unemployment, and injustice between debtors and creditors during the depression of the 1930s. Mr. Kriz was not alone in the belief that the program Mr. McKenna wants us to follow now would result in the same type of drastic deflation from which we have suffered so often in the past. Several of the men present voiced fears of a deflation if such a program were adopted now.

On the other hand, Mr. McKenna's righteous indignation with the present money system, which is tied to nothing at all and which is steadily whittling away the value of our dollar, is also well justified. There is no question but that many millions of hard-working Americans are being robbed under the present system. The value of their savings is being destroyed by a steady inflation of the per-capita supply of dollars.

The only logical way out of this tangle is to abandon the gold-credit mechanism and adopt the type of system that is implied in the views of Bradford B. Smith. There is no other way -- consistent with a free-enterprise economy -- of protecting ourselves from both inflation and deflation.

Mr. George made the point that before the United States should consider restoring domestic convertibility, it would be absolutely necessary that a number of other countries put into effect "reforms ... that would be extremely radical and difficult and politically unpalatable." (p. 62). Mr. McKenna then asked:

> "Is it wrong that Americans should have good money when foreigners have not yet attained good money? Couldn't America have good money even though other countries can't afford good money? Don't Americans deserve it because we work harder and cause the money to come into the Treasury in exchange for our labor and our risk-taking? What is wrong with Americans having better money? We have better automobiles and better everything else. *Better money would be a leadership for the world,/i>." (p. 65) (Italics added)*

Mr. McKenna is absolutely right! America does deserve a good money. And without any question, "better money would be a leadership for the world." But the hard fact is that gold is not as good a money as we could have, because its supply does not keep pace with population. And gold-credit is a still worse money, because it collapses periodically. And another hard fact is that gold is an international commodity -- and therefore, if our money is linked to gold, we must consider the situations that exist in other gold-standard countries. It would be foolhardy not to. You can rest assured that the speculators in foreign exchange are keenly aware of the relative strength of the credit situations in different countries. For us to ignore the situations that exist in other gold-standard countries would be to invite disaster.

In other words, if we stick to gold, it's unfortunate but true that Americans can't have as good a money as they deserve. And it's also true, as Mr. George pointed out, that certain basic reforms in other countries are needed before we can get the gold standard working as it used to work. And that means "meddling" in foreign affairs -- a process that is repugnant to most Americans. If we don't meddle, there's no possibility of making the gold standard work; and if we do meddle, we get a standard we don't want anyhow because of the "barbarous" way in which it works. It should be easy for us to make up our minds what to do when confronted with those alternatives!

Just in case there is still some doubt concerning the havoc-wreaking potentialities of the gold-credit mechanism, let's take up the question of the cause-and-effect relationship between the breakdown of that system and WAR. Mr. Bernstein mentioned the widely held belief that monetary difficulties grow out of great wars (p. 75). Now there is no doubt that wars have a disastrous effect upon the gold-credit mechanism. But it would be naive to suppose that wars are the cause of our monetary troubles. It is far more likely that our monetary troubles cause war, or at least cause the increasing friction between countries that is conducive to the outbreak of war. Consider, for example, the following description of the situation existing in Europe just prior to the outbreak of the first World War:

> "The rapid industrialization of Germany had already subjected the gold-standard system to a considerable strain, and German competition runs like a leitmotif through the testimony of those we have consulted concerning the operation of the London financial system during the decades immediately preceding the war. It is probable that, had there been no war, some of the characteristic features of the gold standard as it existed in 1914 would have had to be modified. In fact, the growing coordination in the seasonal influences in the Berlin money market with those in London, while at the same time cyclical influences in the two markets were showing more and more independent characteristics, is evidence of the development of a new situation." (pp. 107-108)

(The above had been reprinted by the Economic Forum from William Adams Brown, Jr., "The International Gold Standard Reinterpreted 1914-1934," Rational Bureau of Economic Research, Inc., 1940, Volume 11.)

Mr. Brown's observations given above confirm those of Colonel House, who was sent to Europe in 1914 as President Wilson's personal representative. Col. House reported on June 26th that the competition of the "money-lending and developing nations" was responsible for "much of the international friction." (Charles Beard, *The Rise of American Civilization*, Vol. 2, pp. 611-612).

There is also good reason for believing that some of the friction existing between countries prior to the outbreak of the second world war may have had its roots in the gold-credit mechanism. In this connection, the following quotation from the National City Bank Bulletin deserves careful scrutiny:

> "A second important reason why gold is unlikely to lose its value is that not only the United States, but other countries as well have large vested interests in gold. The British Empire alone accounts for nearly half the gold output of the world, and in many other countries gold production is an important national asset. *These countries would not look with favor upon the displacement of gold as a monetary metal; and even in the event of political changes resulting from the war these vested interests will remain, though possibly shifted to other national jurisdictions*." (p. 70) (Italics added)

It will be remembered that Germany had made an effort to get out from under the gold standard during the 1930s. She had carried on quite an experiment with "fiat" money. (See quotation from Dr. B. M. Anderson, Jr.). Now if the gold standard countries "would not look with favor upon the displacement of gold as a monetary metal," it is reasonable to suppose they had tried to hinder the success of Germany's experiment. And the obvious way to hinder the success of that experiment would have been to discount Germany's currency in such a way as to discourage businessmen in other countries from accepting that currency. That would have forced the Germans to engage in barter agreements -- which is what actually happened. And since barter is, at best, a long step backward in the economic development of the world, it is reasonable to suppose that the increasing tensions resulting from such unsatisfactory arrangements would have been conducive to the outbreak of war.

It can be argued, of course, that it was perfectly natural for the bankers of the gold-standard countries to discount Germany's currency if it was not redeemable in gold. That would have been in accordance with the way the international gold standard is supposed to work. But let's face the fact that such a system leads to friction between those countries that wish to keep the gold standard and those countries that wish to free themselves from the tyranny of the gold standard.

It can also be argued that Germany was forced to barter because of her fiat money -- the implication being that if the gold standard were abandoned by all countries, then all foreign trade would have to be done by barter arrangements. But that is not so. Germany was forced to barter because of the clash between the international gold standard and Germany's system of a national "fiat" money that was independent of the gold standard. If there were no international gold-standard, there would have been no clash and therefore no necessity for barter. International trade would have been regulated by mild changes in exchange rates reflecting changes in the supply of, and demand for, various currencies as determined by change in the volume of imports and exports of the countries concerned. Exchange rates would then always reflect supply-and-demand relationships between imports and exports rather than reflecting the degree to which currencies are convertible into gold. (A fuller discussion of this subject is given later.)

So to those who try to blame the breakdown of the gold-credit system on wars, we have a perfect right to say that there would be less tension in the world, and more genuine cooperation between countries, and therefore less chance of wars breaking out, if the gold-credit system were abandoned by all countries.

Now let us consider some of the views of Henry Hazlitt. His introductory remarks before this group of men should be carefully digested:

> "A very wide diversity of opinion has been expressed around this table. That is after all not too surprising, because the question we are discussing is an extremely complicated one. We are trying to decide a matter of practical policy -- whether and when and how to return to a gold standard, and at what rate. Even if we were all in complete agreement on basic monetary theory, we would still be almost certain to disagree concerning some details of policy, because these necessarily involve personal judgments and estimates -- not to mention sheer guesses -- which are unlikely to be the same for any two persons.
>
> "*But it is obvious that we do not even agree on basic monetary theory*. What determines, for example, the value of money, or the 'price level?' Is it the mere quantity of money, whether that money consists of gold or of paper? Is it the quality of the money? Is it the weight of gold in the monetary unit? Is it the value of gold as modified by the quantity and quality of credit? Or is it some combination of factors still more complicated? And what is the relative role played by each factor?
>
> "I do not mean to raise these far-reaching theoretical questions in this discussion. Obviously we do not have time to discuss them adequately. I cite them merely to call attention to the fact that most of us around this table would give different answers to such theoretical questions. And that is one of the reasons why we are giving different answers to the question of practical policy." (p. 81) (Italics added)

The questions Hazlitt raises are basic. And until agreement is reached on the answer to those questions, we will be floundering along with either a gold-credit mechanism that is "managed" by those who speculate in gold-backed currencies, or a gold-credit mechanism that is "managed" by bureaucrats.

What, in fact, determines the value of money? That is the basic question. And it's about time we face the fact that the value of money is determined by supply and demand -- the same as everything else that enters into exchange. There is no hope of making any intelligent progress in the solution of our economic problems unless the law of supply and demand is accepted as a valid law that applies to all things that are exchanged. And an application of the law of supply and demand to our monetary problem results in the conclusion that we must provide ourselves with a supply of money that varies directly as the demand for money. The population theory of value (law of total utility) would indicate that the demand for money in a fully developed market economy varies directly as population. Therefore, our supply of money should also vary directly as population.

An application of the law of supply and demand to the question of what determines the value of money is most helpful in understanding what has happened during the last 300 years. This, of course, has been covered in some detail in the earlier part of this book. But as a brief summary, we can note that the supply of money offered some promise of being stable prior to the use of bank credit. With the introduction of credit banking, the supply of money has been most erratic, because of the inherent instability of bank credit. And naturally the erratic changes in the supply of money caused fluctuations in the demand for money -- fluctuations bearing no relationship to changes in population (which normally would determine the demand for money).

Hazlitt also discusses another fundamental point as follows:

> "There is obviously a question of morality involved when a government, like the government of the United States in 1933, deliberately repudiates a written contract in which it has guaranteed its bondholders to pay them dollars consisting of a specified weight and fineness of gold -- and then laughs the whole thing off and says it hasn't got that much gold and anyone was a fool who took the promise seriously in the first place.
>
> "If a man who conducts a warehouse accepted storage of wheat from you and then announced that he wouldn't return more than fifty-nine out of every hundred bushels of your wheat, no one around this table would say that this was merely a technical change, and that no question of morality was involved. But in this age of statism, alas, we have accepted the contention that governments are entitled to be immoral." (p. 83)

Yes, there is a question of morality involved. And it's a very important question. But let's not forget that the first act of immorality was committed by the early goldsmith-bankers when they created false titles to gold. By legalizing that immoral act, we caused the many repudiations and bankruptcies that have occurred since that time. The reason we have accepted the contention that governments are entitled to be immoral is that we have unwittingly accepted the contention that bankers are entitled to be immoral. If we will put our banking system on a morally sound basis -- if we will face the fact that it is immoral far a banker to create imaginary deposits against which checks can be drawn -- then perhaps we can begin correcting some of the other immoralities that plague us today.

Before closing this chapter, I want to tell you of the predictions made by those participating in that round-table discussion sponsored by the Conference Board Economic Forum:

Five of the sixteen present predicted that we would restore gold to circulation (make our currency redeemable in gold) within five years. Seven predicted that if we don't restore the gold standard, we would have further substantial inflation five years from now. And eight expressed fears of a deflation if we restored gold to circulation at the present price of $35.00 an ounce.

That's a mighty dim outlook any way you look at it! My own prediction is that unless some well-organized and well-financed group takes on the task of enlightening the public on the fundamentals of sound money, there will be a return to full convertibility in less than five years. This will be followed eventually by another big crash that will be blamed on our free enterprise system as usual. By then, the American people will probably have had enough of this boom-bust system. Some home-grown dictator will rise to power and the noble experiment in freedom started here in this country one hundred and seventy-eight years ago will have come to an end. The triumph of international socialism will then be assured.

The above prediction is nothing more nor less than a projection of the past, through the present, and into the future.

I would like to say a few words about the one qualification of my prediction -- that qualification being: "unless some well-organized and well-financed group takes on the task of enlightening the public on the fundamentals of sound money..." It is possible, of course, that no existing organization will have the courage to tackle this project. In that case, the public will have to form a new organization. Where there is a need for something of this sort, you can be sure the answer will be forthcoming. Man will not sit idly by while the things he treasures most are destroyed -- not when he knows the cause of the destruction and what to do about it.

This great country of ours was built by the combined efforts and ingenuity of all people engaged in the production of wealth. That includes almost everybody. Some have contributed more than others. And it is reasonable to expect that we should look primarily to those who had the most to do with the building of our economic system for the inspired leadership it will take to preserve that economic system.

Let us take up now, a proposal for monetary reform that satisfies the most exacting requirements of a sound money -- a money free from the whims of bureaucrats, a money that will not give us alternate periods of inflation and deflation, a money that will serve us well regardless of what happens to the monetary systems of other countries, and a money that does not necessitate our "meddling" in the domestic affairs of other countries.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER VIII: Monetary Reform]

The next logical step in the evolution of banking is the adoption of 100% reserves behind all deposits subject to check. The necessity for having 100% reserves behind all checking accounts stems from the fact that prices can not be in terms of our legal standard of value unless our medium of exchange coincides with and is fully representative of our legal standard of value.

When our legal standard was gold, we made the mistake of allowing banks to dilute our medium of exchange with paper money (notes and checks) that was not fully representative of gold. England recognized that the primary cause of her troubles was this lack of relationship between paper money and gold -- but she made the mistake of distinguishing between notes and checks, claiming that notes were money but checks were not. The result was that the power of banks to create imaginary deposits against which checks could be drawn was left unregulated.

We made the same mistake in this country when we adopted the National Banking System in 1863.

Today almost all students of the subject agree that there is no basic difference between notes and checks. Therefore, all the reasons for taking away the banks' power to create credit by the issuance of notes apply with equal force to the banks' power to create credit by creating imaginary deposits against which checks can be drawn. This argument can also be stated another way: If we're going to allow banks to continue creating credit by creating imaginary deposits, then we should restore their right to create credit by issuing notes that aren't fully representative of gold. That would be the consistent thing to do. But nobody has suggested doing such a thing, because everybody recognizes that it is wrong for banks to have the power to coin money -- and the power to issue notes is certainly equivalent to the power to coin money. The power to coin money is supposed to reside solely in our Congress. But the power of banks to create imaginary deposits on their books against which checks can be drawn is likewise equivalent to the power to coin money. Over 90% of our medium of exchange today consists of checks that are not backed 100% by our legal standard of value. It is because our banks have usurped the power of Congress to coin money, that our government has been forced to interfere with the business of banking. And if we continue with our present system, we can expect government interference in banking to steadily increase. The end result will be a nationalized banking system.

There is no question that the power to regulate the value of money -- which is basically the power to control the supply of money -- should reside solely in our government. That is why the framers of our Constitution gave the power to Congress. But in order to protect ourselves from an arbitrary control of the supply of money, and in order to preserve a free banking system and a free capital market, we must recognize that it is unconstitutional for our banking system to create money by creating imaginary deposits. We must also add an amendment to our Constitution indicating what the supply of money should be. If we wish to maintain a constant supply of money per capita, our Constitution should so state. As Alexander Del Mar said:

> "The more exact the limits of the volume of money are defined in the law of each State the more equitable will it become in its operation upon prices and the dealings between man and man."
> (*The Science of Money*, p. 129)

Let us now take up the problem of converting our present credit banking system into a deposit banking system in which the per capita supply of dollars is kept constant. The method of converting our present system into the new system is best understood by taking one bank and analyzing what needs to be done to convert it into a deposit bank with 100% reserves behind checking accounts. For this purpose, let us take the Wells Fargo Bank and Union Trust Co., of San Francisco, California. Their Statement of Condition on June 30, 1954 was as follows:

]Statement of Condition not reproduced from the original. Totals only are provided here: Total Assets: $515,724,038.74; Total Liabilities: $481,413,566.65; Undivided Profits: $24,853,408.24

Member Federal Reserve System & Federal Deposit Insurance Corp.

*$48,311,886.94 in securities and $500,000.00 of other assets are pledged to secure Public & Trust Deposits and for other purposes as required or permitted by law.

Our objective will be to divide this bank into two separate and distinct sections -- a Deposit Section and a Savings and Loan Section. The function of the Deposit Section will be that of a warehouse, pure and simple. It will operate as the Bank of Amsterdam operated before it became corrupt. Deposits will be accepted for safekeeping. The bank would not be allowed to use these deposits, but would merely facilitate the transfer of claims to these deposits by means of checking accounts. All checks drawn against such deposits would therefore be backed 100% by actual money.

The function of the Savings and Loan Section will be to obtain the savings of the community for the purpose of making loans to the community. The ideal toward which we should strive is a Savings and Loan Section that obtains lendable funds by selling the bank's bonds. In other words, the ideal Savings and Loan Section of a bank should have a bonded indebtedness to the public rather than deposits that are withdrawable on 30 days' notice. And of course, all the bank's loans should mature on or before its outstanding bonds. When operating this way, the bank is free to lend all the savings of the community that have been placed with it -- rather than having to retain a 5% or 10% cash reserve to honor requests for withdrawals. And the person holding a bank bond always has a liquid asset that can be exchanged for money in the event of an emergency.

It is not possible, of course, to attain this ideal overnight. But as a start, the Savings and Loan Section of the bank should be set up much the same as a Savings and Loan Association. It should have a minimum cash reserve of 5% to honor occasional requests for withdrawals. Then, as its outstanding loans are paid back, it should approach the savings depositors -- one by one -- and tell them that their savings can no longer be held as deposits that can be withdrawn within 30 days. Each depositor would have to decide how long a period he wished to make his money available to the bank and buy a bank bond for that period of time. Eventually all savings deposits held by banks at the time of conversion to deposit banks would be converted into bonded indebtedness to the public.

Now let's get down to the practical job of dividing this bank into two separate sections as outlined above. The bank has total demand deposits of $332,395,486.71. These are the deposits against which checks are being drawn and which should therefore be in the newly formed Deposit Section with a 100% reserve behind them. The bank already has cash reserves of $129,940,071.76. (Although these cash reserves include deposits with other banks, the entire amount can be treated as actual cash if all banks are converted to 100% reserves.) To bring the cash reserves of the Deposit Section up to 100% of its deposits requires an additional $202,455,414.95. However, the newly formed Savings and Loan Section will also need $7,450,904.00 to give it a 5% reserve behind its deposits (which total $149,018,079.94). So the bank will need a total of $209,906,318.95 in order to split itself into a Deposit Section with 100% reserves and a Savings and Loan Section with a 5% reserve.

The government will print the required amount of money and lend it to the bank. But since the government already owes the bank $200,563,124.32 (U.S. Government Securities held by the bank), the government will advance the entire $209,906,318.95 to the bank, cancel the government securities held by the bank, and accept the bank's bonds in the amount of $9,343,194.63 to cover the difference.

The bank's new statement [*not produced here from the original*] would then appear as follows:

One point needs to be made crystal clear before going any further. The preceding plan for converting a particular bank into a deposit bank is not offered as a plan that is perfect in all details. Doubtless minor adjustments will have to be made so that each bank is assured adequate funds to tide it over during the change from one system to the other. For example, some of the "Other Liabilities" and "Credits and Acceptances" may be considered as demand liabilities -- in which case the bank would have to borrow still more from the government in order to maintain a 100% reserve behind its demand deposits and a 5% reserve behind its savings deposits. Enough of the details of the plan have been given here to indicate the general idea of how our credit banking system can be converted into a deposit banking system.

In connection with the conversion of all banks to deposit banks as outlined above, the following points should be observed:

1) It would be a good idea to design a new currency. Federal Reserve Banks -- as fiscal agents for the government -- could have the responsibility of exchanging the new currency for all types of currency now in use.

2) The Bureau of Weights and Measures -- whose responsibility it will be to maintain the accuracy of our new standard of value -- can keep a record of how many dollars are needed for the conversion of old currency by the Federal Reserve Banks and for the conversion of our credit banking system to a deposit banking system. This number of dollars, divided by our population, will give us our new legal standard of value -- i.e., the number of dollars per capita that will henceforth be maintained. Suppose that number turns out to be $1500 per capita. It will be the duty of the Bureau of Weights and Measures to see that the supply of dollars is maintained accordingly. Severe punishment should be meted out to anyone found guilty of tampering with that standard in any way.

3) The banks should be required to pay the same rate of interest on their bonded indebtedness to the government as the government is now paying on its own bonds held by the public. (If the government charged the banks a lower rate than it pays the public, the government would be in the absurd position of having borrowed money at one rate of interest from the public, and having lent money at a lower rate to the banks -- the tax-payer paying the difference!)

4) The government should not be allowed to sell any more of its bonds. It should be forced to operate within its income.

5) Gold would be demonetized. The United States would no longer buy gold at any price. Our gold hoard should be sold at the going rate, and the proceeds used to retire more government bonds.

6) Federal Reserve Banks will no longer have power to make loans to member banks. They will henceforth confine their operations to the clearing functions so vital to a money economy. They would also act as fiscal agents for the government.

7) The Federal Deposit Insurance Corporation could be retained to insure the savings deposits of banks until such time as they have been converted into bonded indebtedness to the public. Demand deposits obviously no longer require any insurance, as they are backed by 100% reserves at all times.

8) All government lending agencies should be dissolved. Their current business should be taken over by the banking system. The lending of money is not a proper function of government.

9) Any increase in the supply of money made necessary only by a proportional increase in population, can be obtained by a corresponding diminution of federal taxes below federal expenditures. The new money should be deposited directly in the U.S. Treasurer's Account with the Federal Reserve Banks to balance the budget. Necessary additions to the supply of money would therefore not benefit any particular group of people.

10) There should no longer be any need for a protective tariff. A protective tariff is needed only when the labor of different countries is measured by an international standard of value. By abandoning the international gold standard -- and removing all exchange controls -- we would no longer need the protection of a tariff barrier. Flexible exchange rates would automatically prevent any flooding of our markets by foreign goods. Flexible exchange rates can be relied upon to preserve a balance between imports and exports.

11) Our government's participation in plans for achieving international monetary stability will henceforth be guided and limited by the conviction that such stability can be best achieved if each country stabilizes its own currency.

Now let's consider the effect this change would have on our country. Perhaps the most important result of such a change would be that our bankers and our businessmen could now rely on the stability of the per capita supply of money. The present per capita supply of money would be stabilized. Neither our banking system nor our government would have the power to expand or contract the per capita supply of money. Keep in mind that no new purchasing power would be given to, nor would any be taken away from, any person who doesn't already have access to that purchasing power today. We would merely be putting actual money where people now think money is, merely converting credit (which is now being used as money) into money that has an actual existence.

By establishing a 100% reserve behind all checking accounts we would at last have a medium of exchange that coincides with our legal standard of value. This would mean that our prices would henceforth be expressed in terms of a single standard of value rather than in terms of a double standard, i.e., gold and a fluctuating volume of bank credit.

Banks would now be free to make the savings of the country readily available for loans without the fear of a possible collapse of the money market formerly caused by a loss of confidence resulting from the creation of imaginary deposits. In the past the bankers were fully aware of the instability of bank credit.

Therefore a conservative banker -- anxious to protect his depositors as much as possible -- was reluctant to lend credit on long term during a boom because his deposits were withdrawable on demand or at most on 30 days' notice. And the government -- also aware of how unstable the banking system was -- surrounded bankers with a mass of red tape, rules, and regulations in a vain effort to protect the public from an essentially unsound operation.

Under the new system, the bankers and the government would know that the money market had a solid, non-collapsible base. They would know that the basic cause of bank panics had been removed. The only restriction on the banks now would be that they would not have the right to create credit as they did formerly. They could only lend money obtained by sales of their bonds.

It could be argued, of course, that if the banks will now be lending more freely (because of the absence of fear and uncertainty), then this will have a slightly inflationary effect upon the market until a new equilibrium has been reached. That is probably true. Without having changed our supply of money, we will have increased our liquidity. We will be using our supply of money to better advantage, because nobody will be fearing the possibility of a contraction in the supply of money. But we should not be criticized for putting ourselves on a sound financial basis that permits us to have our savings readily available to those who wish to borrow them.

In order to get the banker's point of view regarding the change outlined above, this plan was discussed at length with several friends in that field. The bankers' first reaction, of course, is that they don't like the prospect of losing the income on all the government bonds they are now holding. But it seems to me that bankers should admit that they have been in a privileged position up until now (the privilege being that they have had the legal right to create the purchasing power to buy government bonds) and that they have been enjoying a "good thing" for many years and there is no real justification for the privilege to continue any longer.

Of course you can't get bankers to admit they have been in a privileged position. They point out that they have done nothing illegal -- in fact they feel quite virtuous at having provided the country with billions of dollars of their credit that presumably was needed as a medium of exchange. But if the government had exercised its constitutional right to provide the country with whatever supply of money was needed instead of borrowing imaginary dollars (bank credit) from the banking system, the banks would not have drawn interest on the $60 billions in government bonds that they now hold. So you can judge for yourself whether they've had a "good thing."

Undoubtedly a large part of the income the banks received from government securities was passed on to their depositors in the form of lower service charges on checking accounts. So the banker has a good point when he says that under a deposit system the service charges on checking accounts will have to be raised. Bankers may even voice the opinion that the public wouldn't be willing to pay such high service charges. But that's absurd. Banking had its origin in the need for such a service. The full cost of safeguarding money and facilitating the transfer of titles to that money (by means of checking accounts) should be borne by each person or company for whom that service is rendered.

Bankers may say that it would be deflationary if they were suddenly placed in the position of having no lendable funds. Although the banks would have no lendable funds at the instant of conversion to 100% reserves, their lendable funds will accumulate every day as their outstanding loans are paid back. The banks will obtain the use of these funds and other savings of the community by selling their bonds. Actually the banks will be able to attract more savings than formerly, because the present government restrictions that keep much of our savings out of the banks will be removed. At present, member banks of the Federal Reserve System can not pay more than 2-1/2% interest on savings accounts. And no company operated for profit is allowed by law to have a savings account. When we remove these restrictions -- and force our government to operate within its income -- there will be a vast amount of savings of individuals and companies that will be invested in bank bonds.

Another powerful stimulus to increased savings will be the fact that money will no longer be decreasing in value. There will be more incentive to save a dollar that maintains its value.

Obviously, however, there will be times when all savings are in use. So the question arises: "What happens at these times?" The answer is that if someone wants the capital to start a new business, he must outbid others for the use of investment funds. From time to time, the demand for investment funds will be of sufficient intensity to cause a rise in the rate of interest -- which in turn will encourage more people to save their money. It is the function of a free market to maintain equilibrium between savings and investments as well as to see that capital and labor are used in the most productive manner possible. If a newcomer is unable to outbid others for the use of capital, the implication is that capital and labor are already being used to the best advantage and therefore a shift in productive facilities is not warranted.

Bankers may ask: "What assurance is there that the public will buy our bonds?" Today the public buys government bonds which are steadily losing their real value because of an inflation of bank credit. If they will buy government bonds that are steadily losing their real value, they will certainly buy bank bonds whose real value will be protected because the possibility of further inflation is removed. The security behind these bank bonds would certainly be all that could be asked for -- loans secured by collateral the dollar value of which is not subject to collapse. (Contrast this with the present system, in which the dollar value of a bank's collateral collapses whenever bank credit collapses.)

The banker may then argue that if these bank bonds are going to be so stable in value, then people will commence using them as money -- much the same as former bank notes -- and therefore prices will once more become inflated. The best answer to this is that you don't see government bonds being used as money today, so why expect bank bonds to be used as money? The bank bonds will not be legal tender. They will not be promises to pay money on demand. And the bonds would bear interest. Any one of these factors would be a great deterrent to the use of bank bonds as a medium of exchange.

Once there is a general recognition of the fact that we can keep prices in terms of our legal standard only when our medium of exchange is fully representative of our legal standard, then the public should frown upon the use of money substitutes (bank bonds) just as much as they now frown upon the use of counterfeit money and as much as they should be frowning upon the use of bank credit. It is just as absurd for us to allow our money to be diluted with counterfeit money, bank credit, or bank bonds, as it was for earlier societies to allow their money to be clipped, counterfeited, and diluted with alloys. If we can't comprehend the importance of having our medium of exchange coincide with our legal standard of value, then there is not much chance of having any monetary system work satisfactorily.

Bankers may then take the stand that it would be inflationary and unsound for the government to put all that new money in the banks. But it should be clear that there is nothing inflationary about it. All of that new money will be money that ought to be in the bank today -- but isn't. It is money that belongs to those who have checking accounts at the bank. Checks are continually being drawn against those deposits. But at present those deposits have no existence except on the books of the bank. And because that situation prevails with all our banks, our price structure is not on a firm basis. By putting a 100% reserve behind all checking accounts, we will be putting our price structure on a sound basis.

Can anybody say it is wrong, or unsound, or unwise, to put dollars where they ought to be? As a result of not having dollars where they ought to be, i.e., as a result of having checks circulating that are not backed dollar for dollar by actual cash, we have had the basis for a loss of confidence and a collapse of our price structure that has periodically caused our entire machinery of production and distribution to collapse. We never have had -- and cannot be expected to have -- confidence in our banks when their deposits subject to check are not backed 100% by actual cash.

The banker may then say that it would not be fair to force him to rely on sales of his bonds in order to obtain money for lending, when other lending institutions such as Savings and Loan Associations are not required to operate that way. And here the banker is perfectly right. At the time each of our credit banks is split into two sections as previously outlined, all lending institutions should be required to gradually convert their obligations to the public into bonded indebtedness. The public should recognize that it is not proper or sound for them to have the right to withdraw their savings on demand, or on 30 days' notice, when those savings have, in fact, been borrowed by others from the lending institutions for a much longer period than 30 days. It is not sound for the simple reason that it is physically impossible for a lending institution to pay all its depositors in 30 days. But it would be sound for a lending institution to sell its bonds and then make loans that would mature on or before the bonds matured. And I understand that Swiss banks make use of this principle to some extent -- as well as the British Building Societies in England (they are the equivalent of our Savings and Loan Associations).

The banker may then ask: "What happens if everybody wants to sell these new savings bonds at the same time?"

Buried in the answer to this question is one of the most powerful arguments against credit banking -- as well as one of the most powerful arguments for reform. Variations in the volume of money-hoarding are inherent in and have a very disturbing effect upon a system of credit banking (the prime example being a bank panic). By converting our system of credit banking into a system of deposit banking and stabilizing the per-capita supply of dollars, we will have removed the basic cause of variations in the volume of money-hoarding.

However, if for the sake of argument we assume that the public suddenly did wish to hoard money (by converting bonds into money), there would be a healthful counteracting force to prevent such action from reaching excessive proportions: The price of bank bonds would fall.

Now contrast the two systems: Under credit banking, there is a justifiable reason for a periodic increase in the desire to hoard money, and there is no deterrent to a withdrawal of money from the banking system for hoarding purposes. Indeed, the justification for the desire to hoard -- as well as the actual hoarding itself -- is encouraged by the fact that hoarding will cause a contraction of bank credit and therefore an appreciation in the value of money.

Under the new system there is no justifiable reason for a periodic increase in the desire to hoard money. There is no reason to hoard money -- because the supply of money can't decrease, and therefore its value won't be increasing. However, if we should assume that an increase in the desire to hoard money should occur, there will be a natural deterrent that will operate to prevent the increase from becoming excessive.

This does not mean, however, that a bank bond would be a poor investment. It should be obvious that any commodity or security will fall in price if everybody holding it decides to sell it. Bank bonds, under the new system, would certainly be one of the safest investments that a person could make. And if someone raises the question: "Wouldn't it be safer to buy a government bond, whose price is maintained by the government?" the answer is: "No. If the price of a bond has to be maintained by the government, you can be sure that the value of that bond is decreasing." In other words, the public should be concerned about the future value of their investments -- not the future price of those investments. Too many innocent people have exchanged their hard-earned dollars for government bonds whose price was maintained by the government but whose value has steadily deteriorated because of the failure of our government to protect the value of our dollar by stabilizing our banking system.

When it is realized that the conversion of our credit banks into deposit banks automatically reduces the national debt by about $60 billion (the amount of government bonds now held by the banking system), many people may think that a sleight-of-hand trick is being played. But there is nothing tricky about it. The banking system acquired those bonds by literally creating imaginary deposits on their books to that amount. As a result of that creation of deposits, our price structure is not on a sound basis. By putting a 100% reserve behind demand deposits subject to check, we're merely accepting the situation the bankers have put us in, and stabilizing it so that it can't collapse. We would merely be putting money where it is supposed to be.

It is amusing to think that two of the main criticisms of a 100%-reserve population standard are directly contradictory -- even though often expressed by the same person! The same critic will call the plan "inflationary" one minute and then turn around and call it "deflationary" the next minute. You have already seen some examples of this. But if you bear in mind that no new purchasing power will be given to, nor will any be taken away from, any person, then obviously the mere installation of this system could not be either inflationary nor deflationary to any significant degree. It would merely stabilize the per capita supply of money in existence at the time the reform is made.

The epithet "inflationary" is often hurled by those who distrust "printing-press money." But it should be clear that printing-press money that has an actual existence would be far superior to our present money (bank credit) that exists only on the books of our banking system, and the supply of which cannot be controlled with any precision. The only danger in having printing-press money would be if we set no precise limits to its supply. This danger is overcome by tying the supply rigidly to population.

It is absurd to call "inflationary" a scheme which proposes to stabilize our monetary system at the existing number of dollars per capita. The reason it is absurd is that the production of wealth per capita steadily increases as we use improved methods of production. The interaction of this constantly increasing volume of physical wealth per capita with a fixed number of dollars per capita is bound to result in a gradually falling price level.

However, this gradual fall in prices will not be deflationary (in the popular sense of causing business to collapse). The rapidly falling prices that resulted from the periodical collapse of the gold-credit monetary system were harmful to industry because prices fell faster than costs, and therefore profits vanished. But if the number of dollars per capita were kept constant, prices would not fall faster than costs except in those industries suffering from a shift in demand. And prices should logically fall faster than costs in such industries. The only way we can be certain that labor is being best utilized, i.e., producing the things that are most wanted (most in demand) is to have production decrease in those industries the demand for whose products declines. Then and then only can we attain maximum production of the things that are wanted the most.

The American people have been sold the idea that "a little inflation is a good thing" and that "a gradually falling price level would discourage business growth." As is usual with so many ideas that have been sold us, precisely the opposite is true. Inflation may benefit a few companies who are in a position to raise their own prices faster than their costs are rising. But the majority of companies are reluctant to raise prices as fast as costs; and therefore, they are robbed of the profits that should result from increased sales.

The greatest stimulant to the sound growth of American business is increased profits resulting from lower costs of production, made possible by a larger volume of sales and improved methods of production. Nothing so dampens a businessman's ardor as to see the profits that should result from increased sales eaten up by increased costs resulting from inflation.

You may ask: "Who, then, profits most from inflation? Who is interested in selling us the idea that a little inflation is a good thing?" The speculators, of course. That does not mean that the speculator does not have a useful role to play in a stable economic system. The speculator performs a very useful service by anticipating changes in the supply of, or demand for, various commodities. But when we allow inflation to take place, we are rewarding the speculator with increased profits that in no way result from the astuteness of his operations but rather from a simple increase in the supply of money. To the extent that the speculator's profit results from inflation, the speculator is merely a parasite living off the productive efforts of others. And the more inflation we have, the more profitable it is to be a speculator and the more parasitical the speculator becomes. History affords many examples of countries that have been consumed by the parasitical speculator that breeds during inflation. But don't for one minute think that the speculator is the basic cause of the trouble, because he is not. Inflation of money is the cause of the trouble. Monetary inflation breeds the speculator. And until we face that fact and permanently protect ourselves from monetary inflation, we can rest assured that parasitical speculators will continue to be with us.

Some people might think that if we stop using bank credit as money, there will be a great reduction in the liquidity and transferability of wealth. But these people are forgetting that bank credit is nothing but a substitute for money. It is money that makes wealth liquid and facilitates the transfer of wealth. The curse of using bank credit as money is that when bank credit collapses, the liquidity of wealth is destroyed. If we furnish ourselves with an adequate supply of money -- and stabilize that money by making credit banking illegal -- we will then be assured of continuous liquidity. In fact, we will be assured of even greater liquidity than we've ever had before. The reason for this is that when bank credit is used as money, bankers are fully aware of the possibility of a collapse of bank credit, i.e., a contraction in the supply of money. Therefore, they will lend only up to 60% of a conservative appraisal of the market price of real estate. They don't dare lend more than that -- because they know that in the event of a contraction in the supply of money, the market price of real estate will fall. Under a system of 100% reserves, there is no danger of a contraction in the supply of money; and therefore, bankers and lending institutions could safely lend up to 90 or 95% of the market value of real estate. (Naturally, however, a banker should be wary of any local real estate boom).

There is every reason to believe we would have greater liquidity -- and certainly more continuous liquidity -- under a 100% reserve population standard than under the orthodox gold-credit system. Some of my "management minded" friends, who steadfastly adhere to the idea that depressions are inherent in a free enterprise system rather than being caused by credit banking, look askance at a system that clips the government's wings as this one does. They insist that depressions will still occur, and that therefore the government must have the power to expand the supply of money during a depression in order to aid recovery.

As explained before, we can expect to still have ripples of economic activity resulting from variations in the amount of private credit transactions. But we no longer need fear complete collapses of economic activity resulting from actual or anticipated collapse of bank credit. However, for the sake of argument, let's assume that a time does come when businessmen "lose confidence." Let's assume that as a result of this loss of confidence, they commence to curtail operations. Then the savings of the community (including business savings) remain "idle" or unused. If such a situation occurs, we would then have to determine why confidence was lost. We should not make the mistake we did before of assuming that confidence was lost because of over-saving resulting from a maldistribution of income. There is no valid reason for believing that such a thing could occur in a free market economy. And there are many valid reasons for believing that it could not occur.

Since the monetary cause for a loss of confidence would have been removed (by banking reform), we would have to look for non-monetary causes, such as government interference with productive processes -- the most likely field for investigation being unwise and unsound tax policies.

A variation of the above argument by my "management-minded" friends is their contention that the velocity of money is of far greater importance than the quantity of money. They therefore wish to have the government free to change the velocity of money by changing the quantity of money as well as by tax measures. But if we make an intelligent application of the law of supply and demand to money, we will see that changes in the velocity of money are primarily the result of actual or anticipated changes in the per capita supply of money. Therefore, if we have a constant per capita supply of money, we will no longer have variations in the velocity of money (except from unwise tax policies, which can be corrected.)

The fact that my opponents wish to use changes in the supply of money as a tool for bringing about changes in the velocity of money is tacit admission on their part that changes in the supply of money can produce changes in velocity. And certainly anyone who understands how the gold-credit mechanism worked during the last 200 years should realize that the business world had every reason to expect changes in the supply of money to take place. Therefore, we should have expected changes in the velocity of money to take place also. And we should not have made the mistake of attributing these changes in velocity to any inherent weakness in a free enterprise economy.

The wise thing for us to do now is to stabilize the per capita supply of money and remove all government and private interference with the supply of money. We should give our free market economy a chance to function with a reliable standard of value before we go off half-cocked on the false assumption that a free market is inherently unstable and subject to collapse.

Some people will claim that the stability of international trade depends upon the use of an international standard such as gold, and would be greatly upset if countries adopted purely national currencies that are not backed by gold.

If the people who raise the foregoing argument sincerely want stability of trade and stable exchange rates -- and also want to use gold as a standard of value -- they had better devote their efforts to establishing a 100% gold reserve. As pointed out earlier, we shall never have stability of trade and stable exchange rates as long as bank credit is pyramided on top of gold. The primary cause of unstable exchange rates is unstable currencies -- which, in turn, are caused by pyramiding credit on top of gold.

Let us compare the operation of an international 100% reserve gold standard with a system of national currencies totally divorced from gold. International equilibrium can be achieved by either system of money. Under a 100% reserve gold standard (in which case, of course, gold would have to be given a much higher price), equilibrium would be achieved by movements of gold between countries which would bring about corresponding changes in price levels and hence changes in imports and exports. Under a population standard, equilibrium would be maintained by mild changes in exchange rates which in turn would lead directly to changes in the quantity of imports and exports.

The gold-standardist will argue that these fluctuations in exchange rates are a bad thing and are very disturbing to international trade. But if you keep in mind that an exchange rate is merely the price of one currency in terms of another, then it should be clear that exchange rates should be flexible. The whole theory of economic equilibrium -- national and international -- rests upon the assumption that prices are free to move in accordance with supply and demand. An exchange rate -- which is merely the price of one currency in terms of another -- should therefore be flexible in order to facilitate the maintenance of international equilibrium.

An amusing situation today is that many gold-standardists do believe in "freeing the exchanges" so long as paper money is convertible into gold. They rightly blame our present pegged exchanges for our disequilibrium. They use good, sound logic to prove that exchange rates between gold-standard countries should be flexible. But they forget that these arguments in favor of free exchanges apply equally well to a system of purely national currencies in which paper money is not convertible into gold.

This question of "national currencies" versus the international gold standard is also fundamental to an analysis of the question of free trade versus protective tariffs. As pointed out before, economic equilibrium -- national and international -- necessitates having free markets within each country and between countries. Prices must be free to move in accordance with supply and demand, in order that equilibrium can be maintained. But free trade under a gold standard -- particularly when credit is pyramided on gold -- produces such disturbances to prices and wages within each country that most countries are forced to adopt tariffs and other means of protecting their producers. This of course, leads to further disequilibrium and eventual trouble.

Free trade, under a system of purely national currencies not tied to gold, would not cause disturbances to the price levels and wage levels within countries; and therefore, we could expect to maintain our free markets and international equilibrium.

Some gold standardists will argue that free trade under a gold standard will not produce disturbances to prices and wages within each country. But obviously, if gold will buy more man-hours of work in country A than in country B, then gold will eventually flow from B to A until a balance is achieved. The gold-standardist will answer this by saying that our highly mechanized system of production can produce goods cheaper than the less mechanized systems of production in other countries. He claims, therefore, that gold will not flow from our country to other countries that have lower wage levels. But what assurance have we that these other countries will not become highly mechanized as time goes on? Some of them already have. And it should be clear that any sincere effort to achieve a better world demands that we encourage the backward countries to become more highly industrialized. But such encouragement on our part is suicidal if we cling to gold.

Those who do not believe that free trade under a gold standard would cause a leveling process to take place between countries should take cognizance of what has happened recently within the borders of our own country. We have had a flow of capital in the last few years from the New England states to the Southern states in order to take advantage of the lower wage levels in the South. This adjustment within our own country is a healthy one and should be encouraged. All sections of our country should enjoy the same level of prosperity, even though this leveling process produces local but temporary disturbances in the high-wage areas. But we don't want such a leveling process to go on between countries. It is too disturbing to the producers within each country. That disturbance must be endured under a gold standard, if we expect to maintain international equilibrium. But if we will abandon the gold standard, we can maintain equilibrium without having this disturbance to all producers within each country.

This argument against the leveling process that results from the gold standard does not mean that we should not be interested in raising the standards of living in other countries. We should encourage the raising of the standards of living in all countries. And that can be best done by encouraging production and trade, which, in turn, can be accomplished by having each country abandon the gold-credit system, adopt a purely national currency, and abandon all tariff barriers. It is not for us to tell other countries what to do -- but at least we can show them how to do it by doing it ourselves. (If the reader wishes to study the subject of gold versus national currencies more thoroughly, I can heartily recommend Charles R. Whittlesey's book, International Monetary Issues.)

The "protectionist" may still be concerned about abandoning all tariff barriers. As pointed out before, it is understandable that producers in our country demand protection from the "cheap" labor (cheap in terms of gold) of other countries when we're on a gold standard. But if we divorce ourselves completely from the gold standard, then there is no excuse for protection -- because there is no danger of a flooding of our markets with the products of other countries. The reason there would be no danger of any pronounced excess of imports over exports is that the price of the dollar in terms of other currencies would commence to fall as soon as our imports exceeded our exports. This would immediately tend to cause an increase of our exports and a decrease of imports until a balance was restored.

When contrasting a population standard with a 100% gold standard, there are still other points to consider. Probably the most important is that international stability would be greatly disturbed for a considerable period by the revaluation of gold that would be required before one hundred per cent gold reserves could be established. It would be necessary to revalue gold to more than 200 dollars per ounce! It will be remembered that when the United States revalued gold to $35.00 per ounce in 1934, gold began flowing into the country in embarrassingly large amounts. Of course, a repetition of such an occurrence could be prevented if all countries revalued their currencies a proportionate amount. But there would still be tremendous unsettling factors resulting from such a revaluation.

In the last analysis, however, the relative merits of a population standard and a gold standard depends upon which standard can be expected to give us the most stable per capita supply of money. The answer should be self-evident.

It can be argued that until we have learned to use gold properly as a standard of value, we should not attempt any new standard. The theory behind this argument is that governments cannot be trusted to control the supply of money -- and therefore it is safer to use gold as money, since nature definitely limits the supply of the yellow metal. But isn't it clear that a government can inflate a 100% reserve gold standard by revaluing gold, debasing coins, and printing more gold certificates than there is gold just as easily as it can inflate a 100% reserve population standard by printing more "population certificates" than the law allows? The gold standard has been mismanaged ever since it was first used. Before the use of paper money that was supposedly convertible into gold, governments repeatedly inflated their money by debasing their coins to an unnecessary degree. We have seen that some historians attributed the downfall of Rome, in part, to this monetary mismanagement. And when the goldsmiths developed the practice of inflating gold by creating false titles to gold (bank credit), the mismanagement of gold became still worse. The world has suffered ever since.

The record of history clearly shows that the gold standard and fiat money are equally subject to mismanagement. The only reason there is confusion on this point is that most people fail to realize the extent to which gold has been mismanaged.

Those who want to see the value of all human energy measured by the supply of a metal which they can control like to criticize the use of fiat money (the only logical alternative to the use of gold). To do this, they shout loud and long about the misery that has resulted from every mismanagement of fiat money. But they say nothing about all the misery that has resulted from the mismanagement of gold.

An unbiased appraisal of history would support the conclusion that both fiat money and gold have been grossly mismanaged. It would also support the conclusion that fiat money has repeatedly saved our western civilization from complete disintegration. Every time that the gold-credit mechanism has broken down -- and there have been many such times -- it has been necessary to resort to a stronger, more reliable money -- a "fiat" money -- to prevent the complete disintegration of society that would otherwise have occurred.

The only reason most people have a distorted view of the relative merits of a gold-credit system and a fiat money system is that all the misery resulting from our gold-credit inflations and deflations has been wrongfully blamed on other causes, whereas all the misery caused by fiat money inflations has always been blamed on the correct cause, i.e., inflation of the supply of money.

Although there is nothing in history to show that "fiat," or inconvertible, paper money is any more unsound than gold, there is plenty of historical evidence to prove that the most unsound money ever devised is the so-called "convertible" money used in a system of fractional reserve banking -- money that is supposed to be convertible into the standard of value but is not backed dollar for dollar by that standard. That type of money gives us a price level that is not in terms of the legal standard -- thereby subjecting us to the evils of inflation and deflation. That is one lesson of history that cannot be disproved.

Those who look with distrust upon "printing press" or "fiat" money are often ignorant of the basic facts about money. They are the ones who say we should have a "hard" money, but they mistakenly associate "hardness" with convertibility into gold. They would call a "fiat" money a "soft" money. Actually, however, the essence of a hard money is not determined by the material of which it is composed -- or the material into which it is convertible. The essence of a hard money is that it has precise limits to its supply. In other words, gold itself is a hard money, because the supply of gold is limited. Bank credit convertible into gold is a very soft money, because there are no precise limits to the supply of bank credit -- i.e., it can expand and contract. And a purely paper "fiat" currency can be a hard money if we set precise limits to its supply, or it can be a soft money if we set no precise limits to its supply. A population standard, as described in this book, would obviously give us a much harder money than the orthodox gold-credit system has given us.

One more point should be made clear about this term "hard" money. Some people are afraid of hard money because they associate it with depressions. The association of these two things in this manner is a mistake -- but one that can be easily explained. Several times in our past history, we have returned to full gold convertibility of the dollar after a period in which the dollar was not convertible. It was always the "hard money" men who favored a return to gold -- and the actual return to gold usually resulted, or was preceded by, a contraction of bank credit with its attendant unemployment. Hence the aversion to what is called "hard money." However, as pointed out in this book, "hard money" itself is not the cause of depressions. The cause of depressions is the pyramiding of soft money (bank credit) on top of gold, i.e., the attempt to mix both hard and soft monies interchangeably.

Some defeatists will argue that since a population dollar can be debased as easily as gold and vice versa, then what's the point in making any change? The answer is that there is no point in making a change if we're going to take the defeatist's attitude that we'll never be able to prevent debasement of our standard of value. But why take the defeatist's attitude? There is no justification for it. The Byzantines maintained an honest currency for over 800 years by simply making the punishment for debasing money so severe that nobody cared to indulge in that crime. If they could learn to respect their standard of value, we should be able to learn to do the same. The fact that we were not successful in prohibiting the debasement of gold by bank credit in the past doesn't mean we can't do it now. The reason we failed before is that we did not realize bank credit debased gold. Once it is generally realized that bank credit debases our legal standard of value, it should be very easy to prohibit such debasement. After all, it's a matter of life or death to our free enterprise system. That system can't be expected to survive without a stable unit of value.

Some people fail to appreciate the necessity for having a precise standard of value. E. C. Harwood, Director, American Institute for Economic Research, has answered this point very clearly as follows: (Taken from his testimony before the Sub-Committee on Banking and Currency, Washington, D.C., March 31, 1954)

> "When they have a fixed standard ..., the future of which is not being questioned, men can judge when 'bargains' are available and act accordingly.
>
> "When there is no fixed standard..., men have an inadequate basis for judging within close limits when 'bargains' are available. Consequently, they hesitate to make commitments, and while potential employers hesitate, the unemployed wait in Government-induced idleness.
>
> "In the absence of a fixed monetary standard... the pressure for continued inflation tends to rob those citizens who have the least economic power of the only resources they have. The widows and orphans, the elderly and the ill in health are virtually defenseless against the ravages of a depreciating dollar that diminishes the buying power of their savings and depreciates the values of life insurance and annuities.
>
> "Technological progress, given a fixed monetary unit and sound fiscal and banking policies, ordinarily would result in gradual lowering of costs and prices that would benefit all consumers. Especially beneficial would this be for those whom most men strive hardest to protect, their potential widows and their children.
>
> "A fixed standard facilitates the achievement of equilibrium among the economic factors of production, the only sound assurance of optimum employment and production, without which there can be neither full employment nor the optimum output of products to purchase."

I wish to make it clear that Harwood is a firm believer in the gold standard and was giving the above views to support his belief that we should have our paper money redeemable in gold. I have purposely omitted his reference to gold and a redeemable currency in order to make very clearcut the basic arguments for a precise standard of value -- which apply to a population standard as readily as they do to a 100% reserve gold standard. But it should be clear that these arguments for a precise standard of value do not apply to the orthodox gold-credit system that Harwood wants. And the reason they do not apply to the gold-credit system is that the attempt to make bank credit convertible into gold is the very thing that destroys the "preciseness" of the gold standard. In other words, the preciseness of a standard of value is determined primarily by the preciseness with which the total supply of money is kept constant relative to the number of people using that money. Men first turned to gold as a standard of value because the total supply of gold was inelastic. It didn't expand and contract. The total supply of money could be relied upon to remain fairly stable when gold was the medium of exchange. But the stabilizing effect of gold was destroyed when we began debasing it with false titles to gold (bank credit). Men no longer could rely upon the supply of money being stable. We no longer had any precision in the supply of money.

In contrasting the relative merits of a 100% reserve gold standard with a population standard from the standpoint of preciseness, it should be clear that a population standard would be superior. Nobody can tell what might happen to the total supply of gold -- nor can businessmen in one country rely upon the supply of gold in that country staying there. Gold is an international commodity.

There are two statements Harwood made before the Sub-Committee on Banking and Currency that need special comment:

The first is: "Only the shrewd speculator and the man of great wealth can expect to profit in the long run from 'managed' irredeemable money."

Now it should be clear that the "shrewd speculator and the man of great wealth" has already profited enormously -- and legally -- from our system of "redeemable" currency. That system very definitely was managed by shrewd speculators, because they had the power to affect the total volume of bank credit by shifting gold from country to country.

It is equally clear that a system of irredeemable or "fiat" money that has no precise legal limits for the supply can be manipulated -- legally -- by the government for the benefit of a few privileged insiders who know what's going on. But there is no opportunity for such mischief -- legally -- with a population standard.

The most we can hope to do is to protect the sanctity of our standard of value by law. So far, we have failed to do this.

The second statement Harwood made that requires special comment is:

> "Because it minimizes the excuse for controls, the gold standard is especially disliked by those who seek to enmesh the economy in a network of socialistic controls."

It is very easy to make such a statement -- but not so easy to prove that there is any truth to it whatsoever. Quite to the contrary, there is considerable evidence to indicate that precisely the opposite is true; i.e., "Because the gold-credit mechanism maximizes the excuse for controls, there is a definite community of interest between the vested interests in gold and international socialism or communism." What is the evidence for such a statement on my part? To begin with, it was Karl Marx -- the father of Socialism -- who made the statement "Gold and silver are not by nature money. But money is by nature gold and silver." Marx apparently accepted the gold-credit mechanism as part of the natural order of things. And after viewing the misery produced by that system, and aware that his race had for centuries been wrongly blamed for that misery, he decided that the only way to emancipate his race was to completely reorganize society so that there would be a more equitable distribution of the wealth produced. It was a noble piece of work in the sense that his objective of emancipating his race through the attainment of a more just distribution of wealth was a noble objective. Certainly his race stood to lose in material wealth by such a change.

Some of the more far-sighted advocates of the gold standard who can comprehend no other type of money but gold -- or paper money that is convertible into gold -- recognize in the Socialist state conceived by Marx the best hope of maintaining the gold standard indefinitely without completely destroying society. The proper functioning of the gold standard in a free economic system necessitates a free movement of gold between countries -- together with an expansion or contraction of bank credit in each country depending on whether gold is flowing into or out of the country concerned. But these fluctuations in the supply of bank credit -- with their attendant periods of prosperity and depression -- will not be tolerated indefinitely by a free people. Ultimately, therefore, if the gold standard is to be maintained, freedom will have to be sacrificed. And if freedom is to be sacrificed, then some idealistic concept must be substituted for it. Marx's socialist state provides that concept. Many very intelligent men and women with strong humanitarian instincts -- who do not, however, understand the basic cause of depressions -- have been forced to the conclusion that Socialism, i.e., a government-controlled economic system, is to be desired. They have been forced to this conclusion because they have the erroneous belief that depressions are inherent in a free enterprise system and they know that we can't afford to let these depressions occur. A Socialist State would have the power to adjust prices and wages and debts as gold flowed out of the country. It would have the power to redistribute wealth -- by its power to tax and spend -- in such a way as to prevent a concentration of wealth in the hands of a few.

There are varying degrees of socialism, of course; but if a person once accepts the idea that depressions are inherent in our free enterprise system, and that therefore the government should have the power to regulate the economy, then the logical conclusion is that complete socialism should be our goal.

Some people will disagree with me on this. They will say that it is not necessary to have complete socialism in order to regulate the economy. They think that the government can accomplish its objective by adopting what they call a "compensatory budget" and a program of taxation designed to bring about a more equitable distribution of wealth. But if we continue on this path, we will eventually learn that the power to tax is the power to destroy. Taxes destroy the incentives necessary for production to take place. And when you destroy the incentive to produce, then the government will be forced to step in and take full control. Socialists are well aware of the fact that we're headed straight for a full-blown socialist state. They know that a "tax and spend" policy will bankrupt the country and make the triumph of socialism inevitable.

I grant you that this theory of a community of interest existing between international socialism and the far-seeing advocates of the gold standard is startling -- to say the least. But any new theory is startling until it becomes evident that it explains hitherto unexplainable things. And many of the events of the past twenty years make a little more sense in the light of this theory: Great Britain, traditionally one of the champions of freedom and liberty -- but also the world's largest producer of gold -- rushing pell-mell down the road to Socialism; the Union of Soviet Socialist Republics -- reputed to be the second largest producer of gold -- a bitter enemy of Nazi Socialist Germany (which had freed herself from the tyranny of gold); the United States -- possessor of over half the world's monetary stock of gold -- siding with England and Russia to crush Germany -- and in later years promoting the growth and expansion of Socialist Russia to the point that she now dominates 800 million people; the extent of the infiltration of Communists in our government and in England -- an infiltration that never could have taken place unless the "powers that be" wanted it to take place.

Although some unreasoning people may be quite angry when they discover what has been going on, a far more sensible attitude is to face the fact that the overwhelming majority of pro-socialists or pro-"welfare-statists" are among the finest people we have. They have been working for what they sincerely believe is the welfare of their fellow man. They made the choice that any real humanitarian would make. And I must say -- in all candor -- that if the gold-credit system is to be retained, the weight of logic is on their side. Forced to choose between a boom-bust system or a "welfare state," I, also, would choose the latter -- as millions of other Americans have done. Fortunately, however, we need not be confronted with such a choice. We can preserve our free economic system and at the same time remove the basic cause of depressions by simply abandoning the gold-credit mechanism and substituting for it a sound money and banking system.

I would like to conclude the discussion of gold versus fiat money with comments on two quotations that characterize the thinking of the gold-standardist:

> "The temporary success of the German monetary and economic experiment led to the superficial generalization on the part of certain opponents of the gold standard that gold had been proved to be unnecessary, that Hitler had found a way to do without gold, and that the long tyranny of gold was over. Parenthetically, I much prefer the tyranny of gold to the tyranny of Hitler. Gold is not capricious." (Dr. Benjamin M. Anderson, *International Currency Gold versus Bancor or Unitas*, p. 12)

"Parenthetically," I much prefer the blessings of a national money -- a population standard -- to the tyranny of gold, or the tyranny of private bank credit, or the tyranny of State credit (Hitler's system). Gold may not be capricious -- but the men who manipulate gold between countries are capricious. That is why we should adopt a national currency that cannot be manipulated -- a currency that does not foster tyranny of any sort.

The second quotation is from the National City Bank Bulletin for December, 1942, p. 139:

> "Economists and governments with an axe to grind may theorize all they like about doing away with gold, but man's faith in gold persists and it is precisely this faith which has made gold the best standard of value and monetary base that has yet been devised. Certainly it seems unrealistic to talk about gold not being wanted when people are paying premium prices to get it, and when governments themselves are hoarding it and unwilling to allow free redemption of currencies for fear that the people will come and take too much of it.
>
> "....... it is difficult to conceive of a monetary system based upon anything but the precious metals commanding the confidence of the people. Monetary systems cannot be built upon fancy theories, but upon the way people think and behave."

The above argument is answered as follows:

> 1) It should be apparent that if we make the mistake of allowing banks to debase gold (by extending credit), then naturally the people who realize that gold has been debased and is therefore undervalued in terms of other forms of wealth will gladly pay premium prices for the yellow metal. But that is no reason for concluding that men have faith in gold and that gold is the best standard of value and monetary base that has yet been devised. All it means is that they have more faith in gold than they do in bank credit.
>
> 2) Certainly one of the most appropriate criticisms of the gold-credit monetary system is that it is "built upon fancy theories" rather than upon "the way people think and behave." If we continue to accept those fancy theories in spite of our knowledge and experience of the way people think and behave, freedom will not survive much longer.
>
> 3) Just who is it that has an "axe to grind?" The National City Bank apparently feels that economists and governments that wish to do away with the gold standard are the ones that have an axe to grind. Now I'm sure everybody will agree that we should all beware of the arguments and reasoning of the ones that are merely grinding their own axes. But let's not be too hasty in deciding who is indulging in this pastime. Let's not be so naive as to believe that there is no vested interest in gold, nor any vested interest in the gold-credit mechanism -- that gigantic confidence game that has been played so successfully by those who understand it. There is really no excuse for being naive about this matter. The National City Bank Bulletin for June, 1940 told us quite bluntly that there is a vested interest in gold. Their statement bears repeating at this point:
>
>> "A second important reason why gold is unlikely to lose its value is that not only the United States, but other countries as well have large vested interests in gold. The British Empire alone accounts for nearly half the gold output of the world, and in many other countries gold production is an important national asset. These countries would not look with favor upon the displacement of gold as a monetary metal; and even in the event of political changes resulting from the war these vested interests will remain, though possible shifted to other national jurisdictions." (p. 70)

Now read that statement again. Absorb it word by word. Then ask yourself: Who is it that's been grinding an axe all these years?

When contrasting the relative merits of a gold standard and a fiat money system, we should also not lose sight of the fact that the gold-credit mechanism leads to friction between countries -- friction that may have played a part in the outbreak of the first and second world wars. And regardless of what the cause-and-effect relationship is between the international gold standard and war, it is clear that something far worse than war does result from the gold-credit mechanism. Slavery is worse than war. Our loss of individual freedom is worse than war. And the evidence is steadily mounting that the primary force behind the drift to the Left is the economic injustice resulting from unstable money. It was inevitable that those who suffered the most -- together with those idealists who are motivated by the desire to relieve the suffering of their fellowmen -- should rebel against the system they thought was producing the suffering. And in their blind struggle to obtain justice, these well-meaning people -- together with those who are not so well-meaning -- are daily doing things that are sapping the strength of our free economic system.

We have seen many examples of the extent to which the Communist party infiltrated into our government. But we blindly ignore the fact that it was our system that bred most of those Communists. And even though we should totally destroy Communist Russia -- just as we destroyed Nazi Germany -- you can rest assured that some new "ism" will be bred to take the place of Communism. Indeed, a good case could be made for the statement that the greatest threat to our freedom today is not the Communists -- but rather the large number of people who consider themselves loyal Americans but who have lost faith in the ability of a free market to regulate itself. They have lost faith in natural laws.

We must, if we wish to preserve freedom, reverse the trend toward socialistic legislation. We must encourage the free market. And we must, above all, put into effect a monetary system that is consistent with a free-enterprise economy.

One last question needs answering. It is sometimes asked: "Wouldn't a population standard hinder the fulfillment of our foreign policy?" That depends on what you think is behind our present foreign policy. If the motivating force behind our foreign policy is to ensure the survival of the international gold standard -- and there is considerable evidence to indicate that is the case -- then obviously the adoption of a population standard will not only hinder that objective but will completely remove it as an objective in foreign policy.

If, on the other hand, our foreign policy were based on the principle of "live and let live" -- as it should be -- and to cooperate with other nations who believe in the same principle, and boycott those nations who do not believe in that principle -- then it should be clear that the adoption of a population standard would definitely help rather than hinder such a policy. The extent to which we can help the rest of the world depends solely on our own productive power and the percentage of our own production we are willing to loan or give them. We should be intelligent enough to realize that the goods other nations receive from us as gifts or loans will be lost to our market, and therefore we should transfer that part of our purchasing to them for the purchase of these goods. The extent of our help should be determined solely by how much money can be raised by voluntary means. Of course, it can be argued that it is too difficult to raise sufficient money by voluntary means and therefore we must have a supply of money that can be expanded to meet the emergency. But that is sheer nonsense. If we want to do something badly enough, we should be willing to pay for it. It does not help at all -- in fact, it does harm -- to expand the supply of money faster than population. An increase of the supply of dollars per capita causes distortions in our wages, profits, and price relationships. These distortions bring about constant wage disputes, work stoppages, and general dissatisfaction with the price situation. The full burden of foreign aid that is financed by inflation falls upon the unfortunate people with fixed incomes. Their real income steadily diminishes.

We should realize that although it may be difficult to raise sufficient money voluntarily to finance our foreign program, it is much better to confine ourselves to that method of financing the program than it is to embark on the reckless policy of inflating the per capita supply of dollars.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[CHAPTER IX: Conclusion]

It is the inevitable fate of a book of this sort to stir up an intense reaction. A person cannot set out to right a wrong without stepping on the toes of those who have profited from the wrong. It is wrong for us to use gold as a standard of value. And it is wrong for banks to pyramid their credit on whatever we decide to use as a standard of value. And the two most powerful vested interests in the country are the vested interests in gold and the vested interests in credit banking. So the struggle that lies ahead of us promises to be an interesting one.

You will be told that the author of the book is a "money crank," a "starry-eyed visionary," an "isolationist." All I ask is that you think this out for yourself. Make up your own mind about this. You decide who is talking sense and who is talking nonsense.

It is very easy to misrepresent the theories contained in this book. But when all the smoke clears away, the stark simplicity of the plan should be apparent to all thinking men. Our present dimensionless, elastic monetary system is converted into an inelastic monetary system with precise dimensions. We merely stabilize our money at the existing number of dollars per capita. This plan gives us the type of money that Bradford B. Smith, Economist for United States Steel Corp., says we need, i.e., an inelastic money whose supply changes only as our population changes.

My fondest hope is that millions of Americans will exercise their rights to speak up and voice their opinions on these things.

There is a gigantic struggle going on to control men's minds. As men think -- so they act. And various interests are doing their best to browbeat all of us into the position where we either agree with them or refrain from voicing our disagreement. When the day comes that we're all afraid to express our opinions, on that day we will have forfeited our right to call ourselves men. We will have lost the heritage that the founding fathers fought so hard to obtain and to make secure for themselves and their posterity.

The epithet "isolationist" is one that deserves further comment. If those who counseled against this country's entry into the second World War -- a war that, with our participation, was bound to result in the destruction of the two natural barriers to the spread of that malignant growth of Communism -- I say that if those men are branded "isolationists," then I am proud to stand on my own two feet and say, with all the conviction that lies within me, "Yes, I am an isolationist!"

If those who believe that each country should have complete control of its own monetary system -- which necessitates having a purely national money bearing no fixed relationship to gold -- are "isolationists," then I am unquestionably an isolationist. But that brand of isolationism is a necessary prerequisite to the attainment of the kind of world we all dream about -- a peaceful world progressing with an ever-expanding free trade between free men.

An isolationist is one who wants his government to mind its own business and not interfere with the affairs of other governments. It is meddlesome governments that interfere with trade -- domestic and foreign. It is meddlesome governments that are hindering the development of free trade between countries. And there is ample evidence to prove that one of the main causes of meddlesome governments is the existence of the international gold-credit mechanism.

The position we find ourselves in today is an extremely delicate one. We made a horrible mistake by abandoning our traditional foreign policy of non-intervention in 1913. But because we did abandon that policy, and because we have intervened in the affairs of European and Asiatic countries ever since, we are now to a considerable extent responsible for the conditions that exist there. And we cannot very well shirk those responsibilities. That does not mean, however, that we should continue with our policy of intervention. We must never lose sight of the fact that Fascism, Naziism, Communism and any other "ism" that makes the government the master rather than a servant of the people is a result of unjust economic conditions existing in the countries concerned.

There is one and only one way to rid the world permanently of these authoritarian governments once and for all, and that is to straighten out the economic conditions that breed authoritarian governments. And our own country should be first on the list for a thorough going over, because we are today the citadel of strength of the international gold-credit mechanism -- the mechanism that has done most to upset economic conditions throughout the world. If we will clean up our own country and show the rest of the world that freedom-loving peoples can solve their problems, we will be doing more for the cause of freedom than has ever been done before. If we will cut out all the grandiose government-managed schemes for helping other countries and substitute the more efficient schemes of voluntary organizations, the people of other countries will then know that the help we're giving them is coming from friendly people who recognize their responsibilities and wish to help -- rather than from a meddling government whose motives have been suspect.

Our future is in our hands. It is entirely within our power to save our free institutions if we act quickly and if we exercise restraint and understanding as we meet each problem that confronts us. But we should realize that the mere stabilizing of our monetary system will not -- alone -- solve our problems. Many evil forces that threaten freedom came into existence years ago as a result of the adverse economic conditions caused by the gold-credit mechanism. Those evil forces have grown and developed in an environment favorable to their growth. Much patience and understanding will be needed in keeping these forces under control until they die a normal death. And they will die a normal death as the environment that favored their growth becomes more favorable to the growth of freedom.

In the meantime, it is of the utmost importance that we allow no demagogue to rise in our midst. Such a demagogue rose in Germany and preached a doctrine of hate. We must not allow such a thing to happen here. Nor is there any excuse for such a thing happening. We have nobody but ourselves to blame for the troubles that confront us. It was our own confusion that kept this havoc-wreaking system going.

Our future is in our hands.

Money and Freedom

An Application of Natural Laws to the Problem of Money -- The Disastrous Economic and Political Consequences of our Unsound Monetary System -- A Suggested Remedy

Robert de Fremery

[EPILOGUE]

(With apologies to the late C. E. S. Wood, author of *Heavenly Discourse*) I can well imagine what God would say were we able to talk with Him after these years of instability resulting from defying His laws. The conversation would run somewhat as follows:

God: I once had great hopes for your form of life. Other forms of life have perished because they had not the means of understanding my laws. But your form of life is blessed with mental powers capable of understanding them. You have, indeed, used many of my laws to great advantage. But in recent times you have attempted to flout my law of supply and demand. You seem to think that some of your finite minds are capable of regulating your economic system better than my laws. This happened many times before in the history of man. And each time it happens, the results are the same. It ends in chaos. Why? Because my laws are designed to produce a maximum of justice for all men. If you disturb the normal operation of my laws, or fail to use my laws to your advantage, you will produce injustice. And injustice will breed discontent, because that is my will. I cannot tolerate injustice.

Man: But God, we were relying quite heavily on your law of supply and demand until we woke up to the fact that it was the cause of a considerable amount of injustice and unemployment. Periodic booms and busts, with their attendant periods of speculation and unemployment, were too much for our people. And it was just as you say. Injustice produced discontent. So we acted accordingly. We took matters into our own hands.

God: (smiling sadly) No, you didn't take matters into your own hands. You took matters out of your own hands and turned them over to your government. Instead of letting my laws determine the value of your productive efforts -- so that each of you would be rewarded accordingly -- you let your government try to do that job. As a result, instead of each of you enjoying the fruits of your own labors, your government decides how much of your income each of you is entitled to keep. And just look at the results! Continual conflicts between different segments of your society. Taxes so burdensome that in many cases individual initiative is being destroyed. An increasing reliance upon your government and a decreasing reliance upon yourselves. Interminable quarrels and interference with the domestic affairs of other countries in spite of the fact that you obviously don't know how to manage your own affairs.

Man: But God, we were forced to turn to our government for help. Private enterprise failed us. We had twelve million unemployed men and their families that had to be fed, clothed, and housed. Admittedly we didn't like what we were doing -- and we don't like the trend of events in the world today. But it seems to me it was inevitable that we had to go in the direction we did. Your law of supply and demand was tried and was found wanting.

God: My law of supply and demand was tried and was found wanting? Don't you realize that my laws continue to operate regardless of all the silly laws you men make?

Man: Yes, God, we have found that your law of supply and demand continues to operate. And I'll admit that it complicates our problems tremendously. We tried to set fair rents, and we got a shortage of houses. We attempted to set fair prices for farm products, and we got surpluses so huge we don't know where to store them. And it's your law of supply and demand that causes the mischief.

God: So that's what you think of my laws?! You think they cause mischief! Have you so little faith in me? Have you so little faith in freedom? (God pauses) Perhaps I have had too much faith in you.

Man: But, God.....

God: never mind. I know what you're thinking. Hasn't it ever occurred to you that perhaps it wasn't my law of supply and demand that caused your booms and busts? Hasn't it ever occurred to you that your troubles may have been caused by the unstable money you people devised rather than by the laws I devised?

Man: Well, some men have claimed that was the case. But they were few and far between. We just couldn't give their ideas serious consideration.

Gcd: I see. Instead of giving their ideas serious consideration, you turned your attention to the ideas of those who had lost faith in my laws? (Man squirms uneasily) Tell me, what were some of the ideas of those who said the cause of your troubles might be the money you devised rather than the laws I devised?

Man: Well, there were several -- I don't remember their names -- who claimed that your laws would produce equilibrium if we had an ideal medium of exchange. In other words, they worked out theories which proved that if we had a perfect money, an ideal money, then equilibrium between total supply and total demand would always result. General over-production would be an impossibility. They further concluded that the fact that we do have what appears to be general over-production is clear evidence that we have a faulty medium of exchange. They blamed our troubles squarely on the money we devised rather than on the laws you devised.

God: They obviously had faith in my laws -- a faith bolstered by understanding. What did some of the others say about the money you have been using?

Man: There have been many different men who have suggested that there ought to be some relationship between our supply of money and the number of people using our money. And obviously a money that is tied to gold -- as ours is -- doesn't fulfill that requirement.

God: Hmm. These men apparently realized that the only way justice can be done between debtors and creditors is to have a dollar that is always equally difficult to obtain. You would have such a dollar if the number of dollars varied directly as the number of people trying to get dollars. My law of supply and demand would see to that. Doesn't that make sense to you?

Man: Yes, but... (he couldn't seem to find the right words)

God: But what?

Man: Well, most of our experts told us we had to have more money as we produced more goods. The argument was that productivity increased faster than population, and therefore we had to have an increasing amount of money to facilitate the exchange of our increasing supply of wealth.

God: And because you were told that, I suppose you believed it? Don't you think these things through for yourselves? That's what your minds are for. (No answer) Isn't it clear that if you increase the supply of money faster than the number of people using that money, then your dollars will be easier to obtain as the years go by? And if your dollars are easier to obtain, then your debtors will be paying back "cheaper" dollars to your creditors -- cheaper in terms of the effort necessary to obtain them. Isn't this clear to you?

Man: Yes.

God: That wouldn't be just, or fair, would it?

Man. No.

God: Then why did you allow the supply of dollars to increase faster than population? What reasons were given you to support such action?

Man: We were told that if the supply of money didn't increase as fast as productivity increased, we'd have falling prices that would cripple our producers.

God: (with an unbelieving look) And you believed that too? Isn't it clear that if your productivity per capita increases while your supply of money per capita remains constant, then costs of production have declined and therefore prices can fall without hurting the producer? And looking at it another way, isn't it clear that if the total value of wealth is determined by the number of people using that wealth, then a mere change in the physical quantity of wealth does not affect the total value?

Man: Yes, but is the total value of wealth determined by the number of people using that wealth? It seems to me that as we produce more, the value of our total wealth increases.

God: Since when does an increase in supply cause an increase in value? That would be a contradiction of my law of supply and demand.

Men: But we assumed that an increase in the supply of wealth was the same thing as an increase in the demand for wealth.

God: But that's absurd! That would mean that as it becomes easier and easier to produce wheat, the lucky wheat grower would get a steadily increasing share of the national income. Everybody would want to produce the thing that was the easiest to produce. Obviously your concept of demand is not a valid one.

Man: Yes, I can see now that we made a mistake. But what reason have we to believe that the total demand for wealth, or total value of wealth, is determined by the number of people using that wealth?

God: You have a law of diminishing utility, do you not?

Man: Yes.

God: That law -- if properly stated -- presupposes a law of total utility. (Man looks puzzled)

God: You people value the total wealth you use, don't you?

Man: Of course.

God: Your valuation of that total wealth doesn't increase just because you have more physical wealth to use. Let me give you an example of what I mean. You people may be consuming twice as much physical wealth as your great grandparents did -- in other words, you have a much higher standard of living -- but your valuation of the wealth you utilize is no greater than their valuation of the wealth they utilized.

Man: You mean that our valuation of wealth on a per capita basis is the same as their valuation of wealth on a per capita basis? In other words, total value is the same as long as there is no change in population?

God: That's right. You seem to be grasping the idea. Doesn't it make sense to you?

Man: It certainly does. The more bountiful the supply of wealth in relation to the demand for wealth, the less each unit of wealth is worth. And the demand for wealth is proportional to population.

God: Good for you. And since the demand for wealth is proportional to population, then you ought to have a supply of money that varies directly as population, so that each dollar will represent a constant amount of demand or value. Right?

Man: Right.

God: Now we're getting someplace. (Pause) You say that some of your men have contended all along that the supply of money should vary directly as population and that the gradually falling prices resulting from such a system would not be harmful?

Man: Yes, God.

God: Then why didn't you people follow their advice?

Man: Oh, they were in a very small minority.

God: What's wrong with a minority? Can't a minority think as well as a majority? It looks to me as if your minority was doing the real thinking here. Do you people blindly follow the ideas of the majority without deciding for yourselves whether those ideas are sound? Aren't you overlooking the fact that every new development starts with a very small minority -- to wit, one man?

Man: That's true enough. But if that one man fails to persuade his fellow "experts" of the correctness of his views, then it is natural that the people would follow the majority of the experts.

God: I don't see anything natural about that at all. Do you people blindly follow your experts without thinking these things through for yourselves? (Pause) Apparently that is what has been happening -- otherwise you wouldn't be in such a sorry state of affairs now.

Man: But God, money is a complicated subject. You can't expect the people to understand it. They have to follow the advice of their experts.

God: Well, that's obviously what they've been doing -- and the results don't look so good to me. But you're wrong when you say they have to follow the experts. Your people are a lot smarter than you think they are. I'm sure they could arrive at a much better solution to their problems than your so-called experts if you gave them half a chance.

Man: No, money is too difficult a subject. You're expecting too much of them.

God: What is so difficult about it? Is it so difficult to see the folly of basing your money on a metal that must be dug out of the ground and the supply of which bears no exact relationship to the number of people needing a medium of exchange? Is it so difficult to see the folly of allowing certain privileged institutions to debase your legal standard of value by creating false titles to that standard? Is it so difficult to see the folly of having no precision regarding the supply of money -- as a result of which great injustice is alternately done to both debtors and creditors by those who can manipulate the supply of money? Is that so hard to understand?

Man: No, I guess not. But God, the people are so apathetic. They don't seem to care about what's happening.

God: I don't believe that. They must care. They just haven't thought these problems through for themselves and consequently don't know what to do. Their experts have confused them. (Pause) Surely your people resent having a dollar that is steadily losing its value?

Man: Yes, that's true. Our inflationary policies make them feel quite helpless, because they can't provide for their own security. We're all getting more and more dependent on the government -- and we don't like it a bit.

God: Then why not put a stop to it? Why not stabilize your money? Give yourselves an honest money.

Man: That's what the gold standard people are asking us to do. They say that the only honest money is one that is convertible into gold on demand. They say that if we would restore the convertibility of our dollar into gold, we could stop inflation for sure.

God: Do you think that it is honest to have a convertible or redeemable money that isn't in fact convertible? You realize, don't you, that you're using about 180 billion dollars as a medium of exchange and that there is only about $20 billion of gold in your country? The most dishonest thing you could do would be to pretend that your dollars are convertible into gold when in fact they are not. It is that type of convertible money that has caused you so much trouble in the past.

Man: But that's not what most of our experts say. They interpret our past history quite differently.

God: There you go -- relying on your experts again. How can your experts hope to understand the past if they have so little understanding of the present?

Man: I'm not sure what you mean.

God: If your experts don't understand how dishonest and unsound it is to have a paper money that is supposed to be convertible into gold when in fact it is not backed dollar for dollar by gold -- I say if your experts don't understand this elementary fact, then how can you expect them to have a correct understanding of past economic events?

Man: But God, you are calling something "unsound" and "dishonest" that we have believed for over 250 years to be sound and honest.

God: What's 250 years. After thousands of years of thinking the world was flat, one of your men came along and satisfied you that it was round. You should never believe something just because others believe it -- even if others have believed it since the beginning of time. If something doesn't make sense to you, then consider it carefully and decide for yourself whether it's true or false. That's what your mind is for. And I can assure you that if you won't use your minds constructively, you will suffer the consequences.

Man: (squirms uneasily but says nothing)

God: When Moses gave you the ten commandments, I suppose he should have added an eleventh: Thou shalt not make promises that cannot be fulfilled. But that's so elementary that he probably thought it wasn't necessary.

Man: (looks confused)

God: Don't you realize that when your bankers give a written or implied promise to pay on demand more than is available in their vaults that they are making promises that cannot be fulfilled?

Man: Yes, but...

God: But what?

Man: Well, they seem to get away with it most of the time. It's only when the people get panicky that the system collapses.

God: According to that logic, any act is sound as long as you can get away with it! What kind of morals do you people have?

Man: Please, God, it's not as bad as it may seem. We just don't look upon our bankers as being dishonest men.

God: Now let's not confuse the issue. I'm not saying your bankers are intentionally dishonest. Obviously they have to be the most trusted people you have. But don't you see that the periodic collapse of your banking system shows that your trust in that system is misplaced? Don't you realize that bank panics furnish you clear proof that what you think is an honest system is in fact fundamentally dishonest?

Man: (no answer)

God: My own laws make it inevitable that your economic system will collapse if you use a "convertible" money that isn't in fact convertible.

Man: What law is that, God?

God: You call it "Gresham's Law." You discovered it long ago when your coins were debased by the clippers. With two kinds of money in circulation -- full-weight coin and clipped coins -- the bad money drove the good money out. The full-weight coins were melted down or exported. (Pause) For some reason or other you people don't realize that this same law operates when you debase gold with a lot of false titles to gold. A bank panic is a perfect example of Gresham's law. The checks (false titles to gold) that you normally accept in daily transactions are suddenly recognized as being of less value than legal tender notes. They are looked upon as being "bad money." So instead of depositing them to your account, you ask for actual cash. And in a real bad panic, even the legal tender notes are looked upon as being "bad money." They are not as good as gold, for the simple reason that they are not fully representative of gold. They are false titles to gold. And the more astute men, who know that gold has been undervalued, will convert their notes into gold, and either hoard or export the gold in anticipation of its revaluation.

Man: But aren't the people stupid to get so panicky?

God: Certainly not. It's your experts that are stupid for believing there is no reason to get panicky.

Man: Well, it seems to me that Gresham's Law is a bad law if it leads to bank panics.

God: No, it's not a bad law. It's a good law. For it can only operate when somebody has been tampering with your money and debasing it in some way. It can only operate when you're using a "double money." And since injustice results from tampering with the currency, it is well to have such tampering brought to your attention. Gresham's Law does that. But you people don't seem to understand what's happening -- otherwise, I'm sure you would have stopped this tampering.

Man: Well, we have stopped most of it. Only the foreign bankers have the right to convert their dollars into gold now. And we have deposits insured up to $10,000. We're not afraid of panics any longer.

God: You may have stopped your panics. But you certainly didn't stop the tampering! Anything that causes fluctuations in the supply of money relative to the number of people using that money can be called tampering. And your supply of money per capita has more than doubled in the past fifteen years.

You people don't seem to realize how dangerous it is to have no precise limits to your supply of money. I suppose it's because you have no faith, or don't believe in, my law of supply and demand. If you did, you'd certainly realize that the supply of money is of great importance in determining the value of money. (God pauses -- and looks far out into space. He seems to be deeply absorbed with some idea. Then he continues) The power to change the supply of money is a tremendous power. It is the power to force debtors into slavery. It is the power to dispossess people of their property. It is the power to rob people of the value of their savings.

Up until 1666 you people had the wisdom to see that such a power must be in the hands of your government. The right of coinage was a Royal Prerogative. The King alone had the power to change the supply of money, and he was expected to change that supply only in the public interest. It is true that some kings abused that power -- but their abuse was insignificant compared to the abuse that has occurred since that time. It is hard to understand how you could have succumbed to the idea that the power to change the supply of money was too great a power to be left in the hands of the government. But you did. And private moneyers have had that power most of the time since then. You have paid a terrible price for that mistake.

Man: I'm confused. First you criticize us for letting the government manage our economy. Then you say that the maintenance of the supply of money should be in government hands. Isn't that being inconsistent?

God: Not at all. Come feast your eyes on this magnificent sight. (Man, perplexed, follows God out into the open where there was an unobstructed view of the heavens above. It was a beautiful, clear night.) That's an awe-inspiring sight, isn't it?

Man: Yes, God -- but....

God: Now just hold on. You want an answer to your question and you shall have it. You men have watched all those heavenly bodies for centuries, haven't you?

Man: Yes, God.

God: Each of those heavenly bodies is perfectly free to move according to my laws, isn't it?

Man: Yes, God.

God: None of them have the temerity to defy my laws, do they?

Man: No, God.

God: That is as it should be. That's the way I want it to be on earth. And that's the way it would be if you people would use the minds I gave you.

Man: But God, I still don't understand why you say that the supply of money should be maintained by the government.

God: Because the proper functioning of the law of supply and demand necessitates your having a reliable standard of value. The accuracy of your standard of value depends upon how well you maintain a constant relationship between the supply of money and the number of people using that money. Your government maintains the accuracy of your standards of weight and length -- doesn't it? (Man nods) Then isn't it logical that your government should maintain the accuracy of your standard of value also? Doesn't that make sense?

Man: Yes, God, I understand now.

God: It grieves me to see what is happening down there. You have made such magnificent progress in so many other fields. You could have had a veritable heaven on earth had you made equal progress in economics. But because you failed so miserably in the science of economics, you have never -- as a whole -- enjoyed the fruits of your labors. An honest money -- together with a free market and a sensible system of taxation -- would allow each of you to enjoy the fruits of your labor. But a dishonest money robs most of you, and unjustly rewards a few of you who know how to benefit from a dishonest money. Then you react against this injustice by abandoning my natural laws instead of providing yourselves with an honest money. (Man remains silent -- so God continues.) I have given you the intelligence to solve your problems. But I can't -- at least I won't -- force you to use that intelligence. I am not a dictator. You people are free agents -- at least those of you who have had the wisdom to maintain your freedom. But unless you act a little more intelligently than you have in the past, you who are still free are going to lose your freedom also. Your destiny is in your hands.

Man: But God, even though some of us solved our monetary problem, I'm afraid there's not much we could do about it. It would be too difficult to arouse the people to action.

God: (with an unbelieving look in his eyes) Too difficult to arouse the public? I can't believe it! Surely they're indignant at having over half the value of their savings taken away from them! Surely they haven't lost their sense of justice! When they lose that, they will lose everything.

Man: No, God. They haven't lost their sense of justice. But they are confused as to what's causing all the injustice. They know they're being robbed. But half of them think inflation is caused by businessmen raising prices unnecessarily. And the other half think inflation is caused by labor forcing wages higher than they ought to be.

God: That's just what's going to destroy you. You are fighting between yourselves instead of fighting your common enemy. Can't you see that inflation is a direct result of having the supply of money increase faster than the number of people using that money? My law of supply and demand makes that inevitable.

Man: That makes sense to me. And it ought to make sense to everyone else. But even supposing everybody understood this, there's still no hope of making such a basic change in our banking system.

God: No hope? Have you deteriorated to that extent? (Pause) But then, it's understandable. Naturally, if you've lost faith in me, you would have lost all hope also. Tell me -- how do you expect to survive the emergencies that confront you without faith and hope?

Man: But God, we do have faith in You. Our leaders proclaim that faith daily.

God: Faith in me must include faith in my laws, and faith in the minds I gave you to understand those laws and use them intelligently. You don't have that faith. The sort of faith you have is not adequate to see you through the difficulties that lie ahead. It is your kind of faith that is destroying you -- slowly but surely. Nothing but a rebirth of a true faith in me and my laws will save you.

Man: But God, let's be practical about this thing....

God: Practical? I always thought I was very practical. One of the most practical things I ever did was to decide to govern the universe by natural laws rather than by direct intervention. It is Man that isn't being practical. You persist in defying my laws and then have the temerity to ask me to help you out of the chaos that results.

Man: (wincing) But, God, if you'll pardon my saying so, I still don't think you're being practical. You're overlooking the fact that the established banking system would not look with favor upon such a change in their method of doing business.

God: I look over everything and overlook nothing. My laws are all-pervasive. Man has the intelligence to bring about any change that will allow my laws to work to his benefit rather than to his detriment. I gave him that intelligence.

Man: But the power and influence of the banks....

God: There's every reason for believing that your bankers will help bring about this change. They are fundamentally honest men. They won't wish to continue doing something that is basically dishonest. And their own freedom is at stake. Not just their freedom as individuals -- but the freedom of the banking system itself. You people need -- and ought to have -- a completely free banking system. That doesn't mean a banker should have the right to debase your money. But it does mean that he should be free to perform the essential business of a banker without government interference. But if you continue to use bank credit as money, then your government will be forced to establish increasing controls over the banks and over the entire economic system in order to assure your country of a stable supply of money. Your bankers -- of all people -- should be able to see this very clearly.

Man: Well, maybe you're right. But how about the vested interests in gold. Surely they will do everything possible to block this. We could never unseat them.

God: You certainly are a fatalist.

Man: I'm just a realist, that's all. You've got to face the fact....

God: I've never been known to do otherwise. And as for being a realist, how can you justify your practice of allowing your bankers to promise-to-pay-on-demand more money than is available in their vaults -- indeed, more money than is in existence? That's the most unrealistic thing I ever heard of.

Man: But God, you know it isn't practical to have 100% gold reserves. The supply of gold does not keep pace with population. And that's why we allowed the bankers to issue a greater number of promises-to-pay-gold than was available in their vaults. We needed more money.

God: Why did you allow your banks to engage in this practice?

Man: Because we needed more money.

God: Why did you allow your banks to engage in this practice? I want the truth this time.

Man: I'm sorry, God. We did need more money. But I'll admit that wasn't why we allowed the bankers to put out more titles to gold than there was gold. As a matter of fact, it was against the law when they first started doing it. We knew it wasn't a sound practice. But somehow the law was changed, and the practice was legalized. We must have been confused to allow such a thing to happen. And we got more and more confused as the years went by. Today we don't see anything wrong in the system at all.

God: Surely some of you see how evil this system is?

Man: Oh yes, there have always been a few men who have been very outspoken in their criticism of the system.

God: Then why didn't you listen to these men?

Man: Our experts assured us that economics is far too complicated to be explained in the simple terms that these men used. The world is too complicated for people to be so positive in their views.

God: You people certainly get some peculiar ideas. What's wrong with being positive about fundamentals? You're positive that 2 plus 2 equals 4, aren't you?

Man: Of course.

God: Then what's wrong with being positive about other fundamentals -- such as the law of supply and demand, Gresham's law, the law of diminishing utility, and the law of total utility?

Man: (doesn't have anything to say)

God: The very degree to which your world is so complicated makes it all the more important that you be very positive about fundamentals. Indeed, most of your troubles today are due to the fact that you're not positive enough about fundamentals. You're too fuzzy in your thinking. You must face the fact that it is not sound for a banker to promise to pay on demand more money than is available in his vault. You must also face the fact that gold is not a valid standard of value. You must use my laws to provide yourselves with a standard of value that can be relied upon.

Man: (shaking his head) Gold has been supreme for too long a time. You can't unseat it after all these years. The people have been taught to worship it. They think it's the only sound basis for their money. God: Gold may have been supreme in the minds of your experts. But in the actual world in which you people live, my laws have always reigned supreme and will continue to reign supreme long after you gold-worshipers have destroyed yourselves -- as you seem bent on doing. (Pause) You know, it's a strange thing. I have so much faith in the minds I gave you -- and you people have so little. I suppose it's because of what you've been taught all these years. You have been taught that gold is supreme.

Man: That's right, God, we have been taught it so thoroughly that it's just like a religion to us. We no longer think about it. We have faith in gold.

God: Yes, so I see. Faith in gold, and no faith in me. Faith in a convertible currency that isn't in fact convertible -- but no faith in a money based on my laws. Faith in your own ability to substitute your laws for my laws of supply and demand, but no faith in your ability to understand and apply my laws intelligently. That's a bankrupt faith -- if I ever saw one. And what is there to sustain such a faith? How long can such a faith survive as your depressions get more severe, your taxes heavier, and your wars more devastating? Faith in gold! Bah! (God mumbles something)

Man: (with raised eyebrows) God, did I hear you swear?

God: (laughing) No, but it wouldn't surprise me if you did under these circumstances. I just said "L." That letter "L" is the difference between God and Gold. You people must choose between them. They can't both be supreme.