FIRST PRINCIPLES
IN MORALITY AND ECONOMICS
on which depend personal well-being and social health and harmony

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Contents

Why Socialists Do Not Appreciate Constructive Critique of Capitalism

FIRST PRINCIPLES is devoted to promoting capitalism, that is, in simple language, free markets and private property. But it is a critic of capitalism *as it operates.*

Socialism favors controlled markets and condemns private property. It is a mortal enemy of capitalism.

FIRST PRINCIPLES is a critic which endeavors to be helpful to capitalism and which bases its critique on the ethics taught in the Law of God. The socialists are critics who mean to destroy capitalism, and who base their critique on ethics contrary to that Law.

Although the socialists and FIRST PRINCIPLES are both critics of capitalism as it exists, there is no harmony in their criticism. Socialism rejects FIRST PRINCIPLES' critique of capitalism; socialism resents that anyone criticizes capitalism *except from a socialist* *viewpoint.* FIRST PRINCIPLES, in turn, rejects the socialist critique of capitalism.

The difference is this: The socialists condemn the merits of capitalism. FIRST PRINCIPLES, instead, condemns the unnecessary deficiencies of capitalism, its deviation from its own intrinsic principles of noncoercion, truth and safety of persons and their possessions. In FIRST PRINCIPLES, the critique is different *in motivation and in content* from the criticism of socialists-communists.

Readers will recognize three positions:

1. Capitalists who have no significant criticism of capitalism as it manifests itself today; these are not the best friends of capitalism;

2. Capitalists who criticize certain moral (and consequently operating) deficiencies in capitalism, which deficiencies are unjustifiable accretions to capitalism; and

3. Socialists-communists who criticize capitalism with the purpose of destroying it.

FIRST PRINCIPLES belongs to class two.

To which class do *you* belong?

Morality Depends Substantially On The Existence Of Private Property

Private property is not an institution that men can abandon without penalty. The possession of private property gives to the owners a sense of responsibility, and a wish to retain what they have, which means that they *conserve* and become *less wasteful.* What men do not own, or do not have to pay for in accordance with their consumption, they *always* waste more or less.

The water supply of the world will probably be the ultimate barricade at which the increase in population will be halted. Nearly everywhere the demand for water is increasing relative to the supply, and the trend is that water will progressively need to be more carefully conserved than it is today.

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The following is a paragraph taken from a commercial advertisement:

> One proved way to stretch dwindling water supplies is to discourage water waste through universal metering. Water consumption in the United States averages 150 gallons per day, per person. When water meters are installed in a previously unmetered community, per capita water consumption decreases by about 50%.

What people do not have to pay for in proportion to their consumption, and what is not their own possession, *they waste.* It is always that way. Even the most conscientious persons are less careful with what belongs to others, and especially to the public, than with what belongs to themselves.

Socialism-communism always impoverishes a people because it does not utilize the *motivation to conserve,* which becomes operative only with private ownership and charges in accordance with use.

Socialism teaches, from each according to his ability to each according to his need. What is the *need* of people? Is it one hundred fifty gallons of water per day per person? Nobody knows what each person needs. He alone can appraise that. One person needs more and another needs less. No government decree can take care of *variable* needs for water by different persons, or the same person at different times. The only effective way to conserve water is to charge for it, and let people determine their own consumption. But what they must pay for will certainly be less wasted than what they do not need to pay for.

Because socialism-communism does not stimulate human effort, by incentive in the form of ownership; and because it does not curb so effectively as capitalism does the *universal propensity to be wasteful* unless something must be paid for; therefore, there is an inherent tendency for socialist-communist societies to be poor. History substantiates that.

"In Forty Days Nineveh Shall Be Overthrown"

The story of Jonah is well known. He was instructed by God to go from Palestine to Nineveh, some 300 miles northeast, and warn the inhabitants of the imminent overthrow of Nineveh because of its sins. In what the overthrow was to consist no information is given.

Jonah demurred. He was unwilling to go because he was afraid that the inhabitants of Nineveh would repent, and that God would then not destroy Nineveh. Jonah apparently felt that under such circumstances, he would look rather silly.

From the foregoing data some tentative inferences can be made. Jonah may have been a well-travelled man. At one time he may have lived in Nineveh. He may personally have known of its sins. He may have deduced clearly that the bad situation created by those sins would soon come to a head. He was probably a linguist who could speak the language prevalent in Nineveh, or at least a language understandable there. And he was probably a powerful speaker. He must have had so much confidence in his message, in his oratory, and the force of his logic, that he was afraid the Ninevites would repent. In his own distant native land this man was under such compulsion from God to go to Nineveh, that he could not rest or have peace of mind. He fled to obtain distraction, and get farther away from Palestine and Nineveh. The storm at sea, his being tossed overboard, and his being swallowed by a fish and later vomited on land are known to everyone.

He then set out for Nineveh, one of the mighty cities of that time. Its exact site is now known by archeological excavations. The city was on the north side of the Tigris river, below where the Khoser river enters the Tigris, and across from the modern city of Mosul.

Jonah entered the city as a street preacher with his ominous message, "After forty days Nineveh will be overthrown." This can be no more than the gist of what he preached. Undoubtedly the reasons why were outlined by Jonah with clarity and force. Jonah covered one-third of the city by his preaching and by that time the Ninevites, as he had feared, repented. He then went outside the city and camped there to wait and see what would happen. But there was no destruction of the city. Jonah was disgusted.

What Jonah preached about Nineveh can be preached about modern capitalism, without being specific about the time, something like this: *In four years, or forty years, or, at some time, capitalism will be overthrown.* Why? Because as a system it has departed from basic principles; for example, Thou shall not coerce (kill), in the case of unions; or Thou shall not steal, in the case of the authorized banking and monetary structure. Of course, the people living under the present semi-capitalist system may repent, and then capitalism may not be overthrown.

It may genuinely be doubted that Jonah preached against individual private sin. He almost certainly preached against the *public* sins of Nineveh, that is, sins systematically incorporated in its laws. Similarly, a modern society is vulnerable to destruction when certain sins are officially authorized by the law of the land.

Who has been a modern Jonah relative to capitalism? The name of Karl Marx might be mentioned. He prophesied the destruction of capitalism by progressive aggravation of booms and depressions. Booms and depressions are caused by a specific evil which is authorized by prevailing law, of issuing *circulation* credit. As a modern Jonah, Karl Marx might be right.

But there was a great difference between Jonah and Marx as preachers. Jonah undoubtedly called attention to the *real causes* of the evils in Nineveh, their essential character. Marx, superficially, saw only the consequences of one sin of capitalism, namely, depressions. He did not have real understanding of the true causes of the business cycle. He was no real Jonah.

Capitalism needs not unreasoning defenders or patriots, but genuine critics, who will call attention to capitalistic evils which should be purged. And those critics should be more kindly disposed to capitalism than Jonah personally was to Nineveh. Capitalism needs critics who will preach a return to sound practices with the hope that the message will be heeded, that amendment will take place, and that capitalism will not be overthrown.

But sooner or later capitalism will be overthrown *unless it abandons its public sins,* that is, sins incorporated in its laws.

"The Church In Germany Is Dead"

A friend who has travelled over Europe this summer made the statement given above — "The church in Germany is dead." The only testimony he gave in support of his conclusion consisted in the declaration that the churches on Sunday are practically empty. (His statement referred to Protestant churches.) Empty churches indicated, apparently to him, a profound aloofness or indifference on the part of the people to the church and the religion it teaches.

A year or two ago a family physician who had toured Europe made a similar observation, to the effect: "The churches are full (of tourists) on week days, but are empty (of worshippers) on Sundays."

Whether the conclusion at the head of this article is accepted on the basis of such evidence is a matter on which everyone can have his own opinion.

* * *

If the "church is dead" in large sections of the world, then why? To this question, the following answer is suggested: the churches no longer always teach realities. They often teach, instead, extravagances and foolishness. ("Foolishness" here does not mean the foolishness to which Paul referred in I Corinthians 1.)

Aspects of the Christian religion can be listed under three headings: (1) theology, (2) ethics and (3) cosmology.

1. Much of the *theology* of modern Christianity has become this-worldly and denies supranaturalism. It departs from the historical position of the church. There can be no real Christianity without supranaturalism.

2. The *ethics* of modern Christianity have become sanctimonious — radical extravagances. What is taught in ethics in many churches is unattainable, undesirable, hypocritical, contrary to the nature of things. Ethical demands on Christians have been puffed up to elephantine size. (See Volume I, p. 26ff., especially p. 113ff.) Such *extension* of Christian ethics can be reacted to by ignoring it. Most people do.

3. The *cosmology* associated with Christianity is, alas, very out-of-date. By cosmology is meant ideas concerning the character of the world in which the drama of human action is played. Unless its cosmology — which is the backdrop for its ethics and theology — is brought up-to-date, Christianity can be expected to become progressively less influential. The specific cosmology taught has never been a genuinely *scriptural* matter. It has always had extensive supplements based on current experience, observation, and understanding. The experiences and observations which have become fossilized in religion are anachronistic to most modern people. People neglect the true theology and the true ethics of Scripture, because they (more or less unconsciously) have such a low opinion of the cosmology associated with Christianity.

An example will illustrate the problem. A typical view among devout Christians is that *all* pain, or distress or trouble is the result of sin. Pain is an "evil" they say. Evil entered the world with Adam's Fall. If there had been no sin, there would have been no pain whatever. A friend argued this matter recently with another. He said: "If I suffered no pain, my arm might be ground to pieces in a machine — without my knowing it — by my standing too close to it. Pain is a warning signal. It is a good and not an evil. Yes, pain may be a genuine and direct consequence of sin and evil. But not *all* pain is a consequence of evil or sin."

Some of the basic doctrinal standards of some churches have incorporated throughout their whole texture indefensible ideas in the field of cosmology (as the idea that *all* the trouble in the world is *solely* the result of sin). The denomination to which the writer belongs has such out-dated standards. (This denomination, does, however, permit individuals to have views *privately* which permit radically modernizing out-dated ideas in *cosmology*. But although an individual may *privately* hold such views and be without the taint of heresy, it is forbidden to teach a modern cosmology from the pulpits of this denomination! See J. L. Shaver, *The Polity of the Churches,* Volume II, pp. 34-35. A dynamic application of supralapsarianism to cosmology permits a relatively modern view of cosmological questions.)

But in the present circumstances it is natural that to a wide extent "the church is dead."

Modern economics could make a considerable contribution to bringing up-to-date the outmoded cosmology of Christianity.

"Cheaper By The Dozen"

One of the pioneers in "industrial engineering" — a so-called efficiency expert — was the late John Gilbreth.

Mr. and Mrs. Gilbreth were the parents of twelve children. Gilbreth himself coined the phrase (referring to the having of children): "They come cheaper by the dozen." After his death Mrs. Gilbreth took over the management of her husband's professional practice, and operated it successfully for several years. Husband and wife were each, in their own right, remarkable persons. Two of the twelve children in 1948 wrote a charming biography of their father, under the title *Cheaper By The Dozen* (Thomas Y. Crowell Company, New York). The book has already had a thirty-third printing.

Gilbreth was an insatiable *driver for lower costs in business.* He was the most important originator of "time and motion studies." His goal was to eliminate every unnecessary motion made by a man (or by a machine). The purpose was to reduce the amount of labor and other costs required to attain a given result. His children report that he would confidently walk into a factory as "Zeiss . . . in Germany or Pierce Arrow in this country and declare he could increase production 25 percent — and do it." He taught his children how to bathe to cut off minutes and seconds from the time. He cut down the time of lathering his face by using two brushes, and for a while tried to shave with two razors. He found out that he could reduce the time to button his vest from the bottom up to three seconds whereas from the top down it took seven seconds! It all sounds fantastic. But this man, by his idea, made an enormous contribution to the welfare of this country. He did far more for the common man than most of our presidents.

An individual worker usually develops a certain way of doing his task. It is seldom the easiest, fastest or lowest cost way of doing it. An expert on "time and motion" problems, by studying the work and the movements of the man, can often show ways to make it easier for the man; economize on his motions; speed up the action; lower the cost; and thereby eventually increase the income of the man, because real income must and always does depend on productivity. These time and motion studies do not pertain merely to the man; they include the situation in regard to the raw material with which the man works; the performance of the machine he operates; the handling of material generally; and all related problems.

The men who cover this field of activity are usually graduate engineers, and are described as *industrial engineers.* Gilbreth himself was originally a brick layer, with a keen and original mind. He helped discover and pioneer the whole "idea" of increased efficiency, today known as industrial engineering.

At the end of the book already referred to, an incident is related which basically challenges the idea of *efficiency* and *industrial engineering.* Some person skeptically asked Gilbreth what the purpose was of all this furore about productivity.

"But what do you want to save time *for?* What are you going to do with it?" "For work, if you love that best" Gilbreth is reported to have replied. "For education, for beauty, for art, for pleasure . . . for mumblety-peg, if that is where your heart lies."

Clearly the character of the question asked of Gilbreth revealed the psychological background of a person who was hostile to the whole idea of efficiency. In short: "What's the use; what does efficiency do for society? Is it not in a sense futile?"

Maybe the question caught Gilbreth by surprise so that he did not go into a complete rationalization of the benefits of efficiency obtained through industrial engineering. He probably found it hard to understand that there are people in the world who would contrast efficiency with joy of living. Such an antithesis is false, and the implied conclusion is erroneous.

What indeed is the result of *efficiency* via the route of industrial engineering? Here is what happens:

1. Each worker becomes more productive. It takes less men to produce the quantity which the market will absorb. This increase of productivity comes potentially from several sources: (a) more and better equipment (that is, more capital per worker): (b) a reduction in his physical exhaustion, by eliminating unnecessary motions and improving necessary motions; (c) by showing him how to accelerate his speed; etc.

2. The result is that some men are thrown out of work. The first consequence of increased efficiency appears bad; but the observation is superficial. The unemployment may be severe or mild. It may only be that no new workers are employed to replace those who naturally retire. But it may be that suddenly five men do the work of ten. Then five become unexpectedly unemployed. What happens to them?

3. In a *free* economy they are unemployed *only a short time*. This requires an explanation. The individual members of society universally have a *welfare-shortage*. You have; I have; your family has; my family has; your friends have; my friends have. We all would be glad to get some things which we now do not have. Make up a list and you will discover how big your welfare-shortage is. We all work, because that *welfare-shortage*

besets us all the time. No matter how prosperous we are, there are some things which we cannot yet afford. (There may be a few exceptions among the *very* wealthy, but they are so few that the generality of the foregoing statement is not really assailable.) *We do not suffer that welfare-shortage, because of lack of money, but because there is in society a lack of productive power by labor. It is not money that is in short supply; it is product that is in short supply.*

4. Now, because men have been "freed" from labor by a new efficiency, a "new" labor power has become available to produce what formerly could not be produced. Just what new jobs those five men in the example will get cannot be forecast. It depends on which shrewd entrepreneur is first to find out what consumers want most over and above what they now can have. The man who correctly "senses" where the new, real extension in demand will occur, which will satisfy what has hitherto been an unsatisfiable welfare-shortage, is the man who will develop new and profitable business which can and will re-employ the men who were disemployed. The standard of living in society will be proportionately higher.

We can now answer the skeptic who was wondering about the utility of what Gilbreth was endeavoring to accomplish: *The purpose of efficiency is to give men more and better goods, more services, and greater comfort in living,* by lowering the amount of labor that must go to produce the old goods.

Real gains in material welfare depend largely on men with the type of mind of Gilbreth. Men of this type, in our estimation, do more for society than almost any class. They *basically* attack the poverty problem of the whole world, rather than trying to ameliorate it by alms from one to another. The good economic situation in the United States versus, say, the bad economic situation in India is in large part because the United States has had men such as Gilbreth, and that business men generally have adopted his psychology.

In a sense the talk about how wonderful *charity* is, is poor blather compared to Gilbrethian efficiency. However, both have their place. But charity alone without a Gilbrethian type of efficiency dooms mankind genuinely to wretched poverty.

Why Standards Of Living In Europe Are Lower Than In The United States

Standards of living in Europe, in a *material* sense, are lower than in the United States. The European civilization is older; therefore, it "ought" to be richer. But it is not.

The explanation is that labor in Europe is less productive than in America. That does not mean that labor works less-hard in Europe than America, although the pace is obviously slower in some cases. The reason why labor is less productive in Europe, and consequently that the standard of living is lower, is that the *amount of capital employed to enhance the productivity of labor is less,* that is, the amount of *capital per capita* is less, or in the common language of America, the amount of *capital per person* is less.

If a visitor looks out of a hotel window in a big European city, what will he see?

For one, he may see a street sweeper with an old-fashioned broom of a primitive sort and with a cart for leaves, paper and rubbish. The process is slow, dusty and not thorough. There are many of these sweepers. In the United States a relatively large, white-painted truck operated by one man, moves down the street at a rapid rate. The machine sprays out water, spins a big modern brush which whirls the trash into a container in the body of the truck. *One* man and *one* machine in the United States do the work of ten or twenty men in Europe. The nine or nineteen men freed from street sweeping can then go to the production of other goods or the performance of other services, previously not accomplishable because the required labor was not yet allocated to it; but now, such really new production can be accomplished. That freeing of much labor from old tasks, to be available for new tasks, is what has already progressed extensively in America; it has not yet developed so extensively in Europe. In other words, the *capital per person* in Europe is less than in the United States.

Or, a view out of a hotel window in Europe may show some construction workers, let us say, those who lay sidewalks. Instead of building a solid and smooth concrete walk — by means of liquid cement brought from a central cement mixing plant in "truck mixers" with rotating drums, and dumping several cubic yards of concrete at a time, and in this manner quickly laying a smooth concrete walk — a man will be seen on his knees laying square concrete slabs about 10 x 10 inches, or 12 x 12 inches, on a sand base. He will tamp them down one by one. One man in a whole day will do less than what in America would be done in an hour or two. Further, the end product as sidewalk is less satisfactory, especially for women wearing high heels, because it is not level and smooth. Again the answer is, Europe does not have the construction equipment (that is, the capital) to make its construction labor equally productive with American construction labor.

The contrast in the availability of capital in the form of construction equipment between West Berlin and East Berlin is conspicuous. As is well known, West Berlin has been rebuilt much more rapidly than East Berlin. Much of East Berlin is still a depressing ruin. But where in West Berlin reconstruction is going forward with steel scaffolding and extensive construction equipment, in East Berlin the scaffolding is of make-shift lumber and much of the labor is by hand rather than by machine. Poverty in East Berlin is worse than in West Berlin *in proportion* as there is less *capital.*

Or, consider the railroads. In the United States there has been heavy investment in the form of elevating the tracks and making underpasses and overpasses. Europe, despite its dense population, has not done so much of that. Many men are employed as gatemen to raise and lower gates. The labor of such gatemen is "lost labor" in the judgment of an American. His greater capital formation has saved labor, and the saved labor has gone into the production of more and more consumer goods and more and more elaborate capital goods.

In the case of housewives, there is a corresponding loss of labor power in Europe. A stroll down a residential street on a weekday morning will permit observing many women who are engaged in sunning themselves and simultaneously doing *hand* knitting or preparing foods. Home *hand* labor is obviously more prevalent than in America where prior processing has been done on a *mass* basis, at much lower cost, *with the cooperation of capital.*

Or, the constant stream of women going to food markets to shop for small quantities is conspicuous. In Europe they lack large home refrigerators or have none; women therefore shop for *one* day's food requirements; they go to the grocery store six days in the week! In America, many women shop not oftener than once a week. They buy in large quantities, because they have (1) the *capital* to get to the store and carry the groceries home, namely, an automobile which is "capital" in this case; (2) the *capital* to store the perishables, namely, a refrigerator and a freezer. This relieves American women so that they can use their labor power at home for other purposes, or can use their labor power in industry or commerce.

In Europe a milkman, with an unrefrigerated cart maybe attached to a bicycle, brings milk to the door. He cannot deliver one-fourth the amount of milk that an American milkman delivers in his specially built refrigerated milk truck. Similarly in Europe the breadman or bakery man also delivers from door to door. He usually first takes an order; goes back to his cart, then delivers the order! All this is "lost" labor power, to anyone whose standard of comparison is one in which more capital is applied to enhance productivity.

In the judgment of an American there is enormous wastage of labor in Europe; but that is only because he judges on the basis that capital might be available (as in America). But the capital is not available.

Of course what is true in Europe compared to America is many times more true for the so-called "under-developed nations."

What will enable the nations of the world to "develop" a higher standard of living in the foregoing sense? The answer is *more capital per person.* But will they obtain that? Not unless they have laws which make capital *safe,* and not unless they consider it a virtuous act to *save* and to *invest in capital.* Even in the United States some intellectuals and some moralists look upon *saving* and *investment* as anti-social and as of the devil! This is so grievous an error that if the idea becomes general it will destroy the prosperity of the western world. Unfortunately the ideas of

1. safety of capital, of
2. stimuli to saving, and of
3. investment in real capital

are inadequately appreciated in large parts of the world, and are specifically *rejected* by the governments and populace of many of the under-developed countries. "As a man thinketh in his heart so he is"; and similarly, as the people of a nation think so they are; which in modern language is nothing else than saying that you must think soundly before you can act soundly. And throughout the world, even in the richest countries, savings and investments are often decried as mean, selfish, worldly, materialistic, wicked and un-Christian! If that is true and is acted on, then men are properly — and inevitably — doomed to poverty and distress.

"High mindedness" does not consist in treating good living with contempt. The Founder of the Christian religion wore some fine clothes and was accused (undoubtedly with some malice) of being a "glutton and a wine-bibber." He did not live austerely just for the sake of austerity. Solomon repeatedly recommends enjoying the good things of this life (see Ecclesiastes 3:24; and 9:7-10). Riches are repeatedly described in Scripture as blessings (although there are frequent and proper warnings against riches becoming a snare).

In contrasting the capital situation in Europe and America there is no intention to minimize the great capital formation which has taken place in Europe. Consider the great capital accumulation in a country as Switzerland with its electric power generating stations, its railroad tunnels, its terraced fields, and its banked lakes. Similarly in Germany, The Netherlands, England, France, etc. But much of the effort which from the beginning went to create productive capital (factories, machines. etc.) in the United States, has in Europe, in ages now past, gone into the construction of what was ornamental, such as elaborate and ornate churches and art museums. This was a development mostly for the upper classes. In the United States the real capital development has been "pitched" to serve the common man, thank God. And in the process of thereby developing a broad material base to a high standard of living, a broad base was also laid for the *subsequent* development of the artistic, the gracious and the intellectual. As evidence of that it can be mentioned that America — largely inhabited by descendants of the lower classes in Europe — is today the intellectual center of the world. Material prosperity is not a hindrance but a base, a foundation, to intellectual and cultural progress.

And what is the essential nature of *capital?* How learn to understand what it really is? The best answer to this question can probably be given by making reference to what Eugen von Böhm-Bawerk (1851-1914), the Austrian economist, wrote in his three volume work, *Capital and Interest,* Volume II, Book I, Chapter 2 (Libertarian Press, South Holland, Illinois, 1959).

The Misesian Explanation Of The Business Cycle

There are many theories which declare that they explain the business cycle — the booms and depressions which frighten everybody. Reference is here made to three of them.

General Overproduction

There is, first, the theory of *general overproduction,* which is so much in conflict with reality that everybody on careful reflection will know that it is inadequate. Everybody realizes that he himself is suffering from a comprehensive *welfareshortage;* there are many things which people *want* — that is, they wish to have them but they lack them. If people lack many things how can there be *general* overproduction? There can be specific overproduction, but *never general overproduction.* But the overproduction bugaboo frightens grown-ups, as a man with a sheet over his head frightens children by shouting "bugaboo" in a disguised voice. Jean Baptiste Say (1767-1832) long ago blew this theory "out of the water" for good, but nevertheless people hold to this illogical theory of general overproduction.

Shortage of Money

Then there is, secondly, the theory of a *shortage of money,* which is equally unacceptable. Adam Smith blew that fallacy "out of the water" in his *The Wealth of Nations* (Modern Library edition, page 406 f.). "Money" in fact is, because of the great issue of circulation credit at the time, in greatest supply at the peak of a boom; the supply of money, the greatest, but nevertheless a simultaneous shortage! This is an obvious contradiction. There is no profound mystery nor profound answer necessary to realize that there must be some confusion in the theory.

The so-called money shortage is a *loan* money *shortage;* it is not a "real money" shortage. The supply of "real money" remains relatively invariable. What is called a loan money *shortage* is really a *too-big demand for money,* which excessive demand is in turn the result of a gross miscalculation of real resources. (See foregoing reference to *The Wealth of Nations.*)

The gross miscalculation results from the unrealized misinformation caused by the earlier issuance of circulation credit — the issuance of, in effect, counterfeit money. But there have been limits to the issue of this counterfeit money, which limits have been set by law (and experience); then, suddenly, people become painfully aware that they do not have enough real resources to complete their programs. The inability to complete the seriously miscalculated programs, and the discovery of the nonprofitability of those programs brings on the depression.

In principle, the *money shortage* explanation of the business cycle is nothing more than a mild version of the idea that printing presses which print money can bring prosperity. Even the peasants in the world know that printing paper does not make them prosperous. Why then should learned folk believe it?

Mises's Monetary Theory

There is a third major theory explaining the business cycle, and this is the *Monetary Theory*. It is also known as the Austrian Theory, because the author of this theory, Dr. Ludwig von Mises, presently visiting professor at New York University, has for the latest thirty years been the outstanding representative of the famous Austrian school of thought in the field of economics. If a distinctive name is to be given to the theory, it should be called the Misesian Theory of the Business Cycle. Say destroyed the false theory of the business cycle which consisted in alleged *general* overproduction; Adam Smith destroyed the false theory of the business cycle which consisted in an *alleged shortage of money;* Mises has supplemented these negative contributions, by a *positive theory which actually explains the business cycle.*

What is presented in FIRST PRINCIPLES is our understanding of the Misesian theory, without thereby, of course, making the author of the theory responsible for our version of it.

There is nothing new or different in our version of the Misesian theory, except maybe *emphasis on an underlying immorality as the real cause of the business cycle.* What Mises as economist condemns as bad economics (namely the emission of circulation credit, that is, illegitimate money), we condemn not only because it is bad economics, but also because it violates two of the commandments of God, to wit, Thou shalt not steal, and Thou shalt not bear false witness. Putting out circulation credit is (1) disguised theft and (2) involves such misrepresentation of the real economic situation that even the sharpest observers and reasoners are tragically deceived.

We are continuing in current issues our analysis of the monetary factors causing the business cycle. The problem is a difficult one. But the "common man" should aim to understand it, and know the correct solution, or else Western civilization will probably eventually collapse; the issue possesses an importance of that magnitude. The four or five issues of FIRST PRINCIPLES prior to this one should be available and known to readers of what follows; also the issues of November and December 1957.

Last month we suggested that the money problem should be considered only from the viewpoint of strict *honesty,* and that considerations of (1) *efficiency,* (2) *liquidity,* (3) *international exchange,* (4) *full employment,* and (5) *price stability* should not be permitted to becloud the real issue. At that time the *efficiency* motivation was given attention. Attention will be given in what follows to these other extraneous and harmful considerations.

When this analysis is completed, it should be apparent that by the whole process which has been followed the residual program left is that of Mises, to wit, the program to prohibit the issuance of *circulation credit,* which circulation credit is a form of counterfeit money, and which FIRST PRINCIPLES opposes on moral as well as economic grounds.

Uncle Frank, A Walking Bank

Before World War I, during the war and especially immediately after the war, a man in the midwest of the United States who had extensive farm lands, and whom everybody trusted, accepted money from others on his note, and in turn used that money in his land deals and to loan to others. The transactions were informal. Everybody trusted Frank. The reason why they trusted him so completely was because whenever they wanted any money they had loaned to him, he would pull out his check book, figure the amount due, and write out a check. Money deposited with Uncle Frank (he was a distant relative) was *perfectly liquid;* it was available *on demand.* He was a "walking bank," as well as a farm operator and real estate dealer.

Frank had come rather naturally to being an unincorporated bank. His father before him had been a pioneer in the territory. The father had been a man of considerable vision who had "financed" many new immigrants who moved into the territory. He made it a practice to loan them enough so that they could buy a team of horses, some cows and hogs, and farm implements. The father, known as Whispering George, had lived and died as a benefactor of the community. The difference between the operations of father and son was in the fact that the father did not "accept deposits," that is, he did not use other people's money. Frank, the son, extended his operations beyond anything his father had attempted.

A thoughtful review of how Frank was operating would have resulted in the conclusion that it was unsafe to loan money to Frank. What *obviously* did he do with the money? He was buying and selling farms, and financing the buying of farms by others. His operations grew to considerable proportions during World War I and especially during the big farm land boom in 1919 and 1920. If Frank was genuinely *using* the money to buy land for himself, and to loan it to other buyers of farm lands who were buying through Frank as a broker, what would happen if all, or even a goodly number of those who had deposited money with Frank requested the return of their money? Frank had it pretty much invested in real estate. Real estate is generally not a liquid investment, but at the time (1914-1919) farm lands themselves were very liquid; speculation was rife; prices were rising rapidly; confidence was "in the air." Frank had no trouble to pay out *on demand* requests made by depositors. If he needed money he probably "took his profit" on some farm, and then again had the ready money he needed.

Further, Frank had undoubtedly discovered that, if *A* bought a farm and needed money, then *B* as seller would have as much more cash as *A* had less. If *B* left his money with Frank, then what *A* withdrew was balanced out. (See Volume III, page 331ff.)

(1) A real estate dealer is an agent; (2) a man who lends his own money is a capitalist; (3) a man who lends the money of others is a banker. Frank had graduated to the status of a banker, with his own capitalist and agency operations inextricably intertwined with his banking operations.

Frank had only *informally* entered the banking business. He had his own capital, more or less liquid, with which to operate. He had, in addition, the originally wholly liquid funds of his depositors. As the ancient silversmiths had learned and the commercial bankers after them, Frank had learned that it was improbable that all his depositors would want their money at one time. As time went on he operated on a steadily expanding scale, without personal apprehensions and with complete community confidence.

In a rising market and in a genuinely expansionist economy, *liquidity* is never a problem, unless a man is grossly incompetent. Frank was not grossly incompetent. He operated successfully for years.

But the great midwest land boom during and immediately following World War I did not last. The rise in prices petered out. The curve of farm product prices, and consequently of farm land prices, first flattened out and began to move horizontally. This was an ominous phenomenon, because Frank's scheme of operation depended on farm lands being highly salable — really liquid. Indeed, why buy and sell farm lands if prices are steady. During the big rise in prices, a farm might change hands three times in six months — each time at a new high price. But as prices steadied, the turnover and the liquidity of farm lands decreased. The walking bank, in the person of Frank, would then not really be so liquid anymore.

The real trouble lay ahead. It hit catastrophically in 1921. There had previously been much speculation in farm products. That meant that inventories had been accumulated. Sooner or later they would have to be sold. Surely, market prices would then become soft.

Calf skins, the raw material for sturdy shoe leather, might be taken as an example. Prices averaged 20 cents a pound in 1913. By 1919 they temporarily rose to more than 90 cents a pound. The following incident is actual history. The calf skin trader of one of the big American packers accumulated calf skins steadily — at rising prices. When they were more than 90 cents a pound he gleefully and confidently asserted to his employers that he would hold his huge inventory of calf skins until he could get more than a dollar a pound. There was danger in this because others were doing the same. Very soon calf skin prices began to decline. And then they crashed in one of the most terrible agricultural commodity price declines in history. The owners of the packing company, whose calf skin trader had been holding skins to get more than one dollar a pound, had their accountants compute their "losses" on calf skins. They were more than one million dollars! One of the owners said: "Fire him; pay him off; he makes me sick every time I see him. I keep thinking of my million dollars."

What was bad for the calf skin trader was also bad for the farmer, and what was bad for the farmer was bad for Frank as a farm owner himself, as a real estate agent, and as a "banker."

What happened to him as a banker? He discovered, to his dismay, that his depositors now wanted their money. They really needed it, or became frightened that they would need it, or they may have come to doubt Frank's *liquidity,* even though they may not have used that word.

But simultaneously, new depositors disappeared. They previously may have bought land at $400 an acre. Now the price was maybe $300. There may have been a mortgage against the farm of $150 or $200 an acre. But land was not "moving." Those who had losses were loath to sell. Those who might have bought kept saying to themselves: "Let's wait, maybe next month prices will be still lower."

Frank, therefore, got no new deposits. But he continued to lose his old deposits.

The price of land in that territory dropped eventually to less than $100 an acre!

The end of Frank as a "walking bank" hardly needs to be reported. He "went broke," lost everything he had, failed to repay his creditors, fell into dishonor, and died not long afterwards, as he was no longer a young man.

Liquidity! What is it? It appears to be something that is beyond question, and nonsensical to worry about, *in a rising market.* It is indeed in such times almost absurd to discuss it or to worry about it. But in a declining market it is a controlling consideration; it just does not exist any more as earlier, that is, it does not exist unless all loans may be "called" on *demand,* and if the borrowers have the ability to repay *on demand;* this they can *never* all do in a declining market. Bankers do not make only loans payable *on demand.* They make mostly time loans — loans not due until one month hence, or three months, or six months, or for a year; or even longer as so-called term loans.

No bank is really *liquid* unless it has *only* loans payable on its demand which loans are to debtors who *can* (that is, are genuinely able to) repay on demand. No bank exists with such a portfolio of loans.

But, it may be urged, loans can so be "staggered" that they will come due ahead of demands by depositors for their funds. This is well and good *if* the depositors do not have demand deposits, but only time deposits which need to be repaid only after ample prior notice of intended withdrawal has been given.

Liquidity of banks is a relative term. There is no perfect liquidity, for the following reasons:

1. The bank's own capital is mostly tied up in its building, its equipment, and in reserves in the Federal Reserve Bank. Its capital is not "liquid" in a perfect sense.

2. The bulk of the depositors' money in the bank on deposit has been reloaned to borrowers *on time,* although the depositors' claims are *on demand.*

3. The bank has, in addition, put out loans or made investments equal to *five* times its reserves at the Federal Reserve Bank. This is like having a building whose top floor area is five times the size of the foundation. Such a building is precarious, and so is such a loan structure.

Admittedly, in a rising market there will not be trouble. But, *inevitably,* in a declining market there will not only be trouble but catastrophy.

Loaning depositors' liquid assets — assets that depositors consider their *liquid* reserve — to third parties who will put them into assets not fully liquid, is on the face of it a dangerous action. A child could reason to the correct conclusion that periodically such a policy will lead to difficulties. Loaning out depositors' demand money *on time* is like being careless with a warehouse full of gunpowder.

But when to that is added the issuance of *circulation credit* on the *Five Times Principle* it is like lighting a big bonfire near the gunpowder warehouse. Trouble is as sure as anything can be in this world.

Economic Definitions Of Various Kinds Of People

The following are rough definitions of people classified according to certain economic characteristics. The definitions are oversimplified in order to facilitate easy understanding. In no case are the terms used meant to indicate criticism or disrespect.

Every man can classify himself as (1) a spender, (2) a hoarder, (3) a peasant capitalist, or (4) a real capitalist. These classifications are arbitrary. The lines of differentiation are not absolute. Many people fall in more than one category, particularly at different times.

In regard to the limited group of real capitalists, there is a subgroup of bankers. There are three main types of bankers; savings bankers, commercial bankers and investment bankers. Again the categories are not watertight compartments. Nor is the description here given of each class complete, but only indicative.

Spenders: All those whose economic program does not involve *saving*, and consequently do not acquire capital. There are two kinds of spenders, namely, (1) those who spend all their income practically *daily* on small purchases and so dispose of their resources, and (2) those who do collect funds *temporarily* in order to make larger purchases, but these purchases are for consumption and not for investing; for example, a man might "save" two thousand dollars in order to take a trip abroad. This is not *savings* in the real sense of the term. It is a temporary accumulation in order to finance a large consumption item.

Hoarders: All those who do indeed save, but who do *not use* the savings for investment nor put the savings to work directly or indirectly, but sequester the savings in a mattress, a jar buried in a hole in the garden, a safety vault, or sewn into the lining of a coat. Hoards do not yield any income, because they are not put to work. Hoarders save, but because of their psychology, do not invest their savings. This may be because they are aware that they do not really know how to invest, and are fearful of the consequences of trying to invest. Hoarders are often timid, or uninformed, or have a mental quirk, but they are not necessarily stupid or queer. They are not necessarily penny-pinchers or extreme savers, who deny themselves the necessaries of life in order to gloat over their coins. They are simply savers who do not invest nor let others use their funds for investment.

Capitalists: All who not only save but who invest their savings in order to obtain an income. Capitalists are one of the two major groups under savers, hoarders being the other.

Capitalists are of two types, peasant capitalists and real capitalists.

A *peasant capitalist* is one who does not know how or in what to invest directly, or who has too little to invest to make direct investment practical. He deposits his money with someone who invests for him. The major groups of peasant capitalists are those who deposit money in savings associations or in savings banks, who buy insurance, or who buy a house primarily for their own residence needs. They are people who may be extremely intelligent in some profession or business, and do very well in obtaining a good income and in saving a prudent proportion of it, but *they do not themselves know how or in what to invest and by that process themselves determine the direction of investment by society in real capital goods.* A peasant capitalist is one who saves for obtaining an income, but who does not himself know how to invest directly in a business venture. Savers who never study to become direct, wise investors remain a peasant type of capitalists.

A *real capitalist* is one who saves and invests directly in order to obtain an income. Real capitalists are individuals who themselves decide what farms, houses, or businesses to buy for income; or what bonds and of what maturity and of what interest rate; or what stocks, in what companies, in what industries and at what yields and prices. These people are *real* capitalists. They earn, they save, *they invest directly.* If they invest unwisely they lose their capital and are not capitalists any more. Being real capitalists does not make them wise or permanent capitalists by any means. They are real capitalists not because they are successful but because of the function they undertake to exercise.

Savings Bankers: Savings bankers are real capitalists who have put some of their own money into the organization of a savings bank, and who accept *time* deposits which come mostly from peasant capitalists. These deposits are not demand deposits which can be withdrawn on demand. The legal terms controlling the acceptance of savings deposits are such that the savings banker can, if he wishes, require prior notice before he is required to pay out to a savings depositor what he has deposited. The savings banker reloans the deposited funds to borrowers. These loans are seldom demand loans, that is, the savings banker seldom makes loans which he can recall on his own demand. He makes instead time loans, due in thirty days or sixty days, or three months, or a half year, or a year, or longer. Presumably he selects his investments so that he can be rather liquid, that is, so that he can make payments to depositors at the due date after proper notice from them. A savings banker is an agent between lenders and borrowers, especially lenders who are peasant capitalists and borrowers who are small borrowers. But the activities of savings bankers are not limited to this. Some of their depositors may be highly sophisticated "real capitalists" using a savings account in a savings bank for a special purpose, in a shrewd manner.

Commercial Banker: Commercial bankers are real capitalists, (1) who have put some of their own money into the organization of a commercial bank, (2) who accept *demand* deposits from peasant and real capitalists; (3) who loan out part of their own capital and part of the sums deposited, mostly, on a short-term basis, and (4) who possess the special privilege of manufacturing money in the form of *circulation credit,* in an amount five times the reserves which they have deposited in their Federal Reserve Bank. Commercial banks are more vulnerable than savings banks, because their deposits are almost all demand deposits and much the greater part of their loans are time loans. A commercial bank is never liquid in the full sense of the word. But the unique feature about an American commercial banker is that he is granted by law a special privilege, which, if he did not possess it but nevertheless employed it, would be known as counterfeiting money. A commercial banker is not a counterfeiter in the full sense of the term. A counterfeiter produces false money *to benefit himself.* A commercial banker produces circulation credit (false money) *to benefit society! That* is the theory!

Stock broker: A stock broker is an agent, who for a commission, sells or buys stocks for real capitalists, whether wise or foolish. A stock broker does not raise new capital but is an agent in the exchange of existing capital. What a real estate agent is in regard to real estate, a stock broker is in regard to stocks.

Investment Banker: An investment banker is primarily an agent between *long-term* borrowers and *long-term* investors. This contrasts with commercial bankers who are primarily agents between short-term borrowers and depositors who can demand their money at any time. An investment banker *underwrites,* that is he undertakes to assure a big borrower (usually a corporation) that he will raise a certain amount of money for such borrower permanently or for a relatively long term — five, ten, twenty, fifty or more years. If he cannot sell the securities to the public, he undertakes to put up the money himself. An investment banker is an agent; he does not have the right to manufacture money in the form of circulation credit. An investment banker sells either stocks or bonds. He does not accept deposits. He uses his own capital or is a borrower at a commercial bank. An investment banker is a very real *real capitalist.* He determines the direction of long-term investment.

Circulation Credit vs Commodity Credit Again

If you seek credit, the purpose is to buy something, or to pay for something, bought earlier but not yet paid for; (there are various secondary reasons such as to restore your buying power, if you have suffered losses, etc., but these are of no great consequence). To get credit means that you get purchasing power.

Someone grants you credit, say, a banker. He gives you currency (paper bills), or he credits your checking account and you write checks against the credit.

The crucial question is: *where* did the banker get the money? There are two possibilities.

1. He may have got the money from someone else, who did not wish to use it or at least was not using it. In this case, the banker was not the real creditor; the banker was only the agent between you and another; the real creditor was the man who deposited money in the bank, which he himself was not using. He was buying less; now you can buy more. As much less as he can buy you can buy more. Total purchasing power has not been increased. Because total purchasing power has not been increased, therefore, your borrowing this kind of credit could not increase prices generally. Credit of this kind is called *commodity credit,* as previously explained in the August issue, p. 243ff. (We are using the terminology of Ludwig von Mises.) This kind of credit does not cause booms.

2. But the banker may have "manufactured" the money. If an ordinary citizen manufactures money, he is called a counterfeiter. He manufactures money *for himself*. A banker is authorized by law to manufacture money far more easily than a counterfeiter. All he usually does is: (a) he asks you to sign a note, and (b) he then credits your account in your pass book for the amount, and then you can draw checks and use up the credit. The banker manufactures money — "counterfeits" — for you and others, that is, for "society." This kind of "counterfeiting" by some queer quirk of reasoning is supposed to stimulate business. If true, a regular counterfeiter's money will stimulate business and welfare just as much. Whereas nobody encourages the lone counterfeiter, everybody encourages the banker. Credit and purchasing power of this kind is *circulation credit*. (Again, we are using Mises's nomenclature and terminology.) *Circulation credit* is *the* cause of booms, and is (through creating booms) *the* cause of depressions. Circulation credit is subtle and social theft. In Hebrew-Christian ethics it is designated *sin*, the word that sounds so odd in modern ears.

Why is counterfeiting evil, and why is circulation credit also evil?

The counterfeiter is a buyer without having first been a producer. All buyers who come by money in regular business (except in the case of fraud or error) are first producers of goods or services. They brought something to market. They gave *quid pro quo*. They robbed nobody. Now, just as a counterfeiter is an illegitimate buyer with money he manufactured himself, so a person getting circulation credit is an illegitimate buyer. He does not give "society" *quid pro quo* any more than the counterfeiter does.

The counterfeiter is a *deliberate* thief. The successful applicant for circulation credit is an *unwitting* thief. He is unwitting, because he does not know whether the credit he is getting from his banker is commodity credit or circulation credit.

(The foregoing is a repetition of what has been written earlier, but material in the current issues will not be understood unless the character of *circulation credit* is thoroughly realized.)

How Circulation Credit Ruined Frank As A Walking Bank

Frank, the walking bank, did not put out any circulation credit. He could not, because he was not authorized to do so. He was not permitted to issue bank notes (paper money) nor open deposit accounts based on circulation credit. Frank dealt only in commodity credit.

Frank's ultimate problem — which caused him to "go broke" — was caused by others putting out circulation credit. It should be interesting to trace how his disaster developed.

As far as Frank was concerned, his only problem was *liquidity*, that is, his ability to repay those who had placed money with him *when they wanted it.* All Frank had to do was use the money in a way so that he could get it back quickly. But Frank did not really do that. He *seemed* to do it, but nevertheless he did not.

Frank invested the money directly in farms for himself, or helped to finance others to buy farms through him as agent. The question is: are farms "liquid"? Can you get your money out of farms quickly?

A quarter section of farm land (160 acres), the usual unit in Frank's territory, at $200 an acre, amounts to $32,000; at $400 an acre, $64,000. Buyers of units of that amount are not numerous. Right away the conclusion can be reached that farms of that kind are not easily and quickly sold. Try to sell such a farm on short notice (without a big discount in the price), and you will discover that farms are not (ordinarily) liquid. Bankers and banking law have, in fact, never considered farms to be "liquid assets." Frank, therefore, was going against experience, and rules based on experience.

Something must have deceived him. What might it have been?

Beginning around 1900 the territory in which Frank was operating had prospered greatly. Urban population was growing; transportation facilities to get products to markets had steadily been improved. Farm income in the territory had risen gradually from 1900 to 1915. Then, during World War I, and thereafter, farm prices rose very rapidly.

The rise in farm land prices from 1900 to 1915 could be largely ascribed to the economics of the territory. There had not been significant *general* inflation of prices, but locally the price changes had been caused by nonmonetary factors. But beginning in 1915 the situation became different. The Allies in Europe (England and France) urgently needed foodstuffs as their own production turned more and more to war materials. Demand for United States farm products became *abnormal.* That was obviously *temporary,* that is, would last only during the war and long enough afterward until normal conditions could be restored. In 1917 the United States entered the war.

What did the government do? It could have financed the war without inflation, namely, by severe taxation. What *could* have been done was not done, because it was considered politically inexpedient. The war was therefore partly financed by selling more government bonds than the people saved and bought. If government bonds had been issued only for as much as people cut down their consumption — that is as much as they really saved — then the bonds could not have been inflationary. But the government put out bonds which entered the money stream.

The method, despite complexities, is relatively simple. The government did not print paper money directly — "run the paper presses," as the expression goes — but did it indirectly. It did run the presses to *print bonds.* Then it "sold" the bonds to the banks who "paid" the government for the bonds by crediting the government's deposit accounts by creating circulation credit. And so, when that happens, printing bonds is *in effect* identical with printing money directly. What has happened is that the government has made itself the recipient of circulation credit, in big amounts.

More money, according to the quantity theory, always means some effect in the form of higher prices, and that is what happened in a big way in 1918 and 1919. The consequence was a big rise in prices of nearly all products, and especially of farm product prices, *and finally of farm land prices.*

What *seemed* to make farm lands liquid assets? Rising prices. Why? Because when the prevailing psychology was that six months later you could get twenty dollars an acre more for the land, people became eager buyers. A farm might be sold by *A* to *B* at $200 an acre; six months later it might be sold by *B* to *C* for $230 an acre; *C* in four months might sell the farm to *D* for $275 an acre; *D* might in a half year sell it to *E* for $330 an acre; *E* might resell it to *F* for $400 an acre.

The *turnover* of any commodity, including farm lands, increases far above normal when prices are rising. The more rapidly that prices rise, the faster the turnover.

But this "liquidity" disappears when the price rise ends. In fact, the *turnover* decreases to less than normal when prices decline.

Liquidity, in a boom, which depends on the issuance of circulation credit, always disappears when there is a stop to issuing circulation credit.

The average man thinks that price rises in a boom are normal and will continue. Only the *most exceptional* men know that the price rises are abnormal and temporary, and cannot continue indefinitely.

And so, the media through which the sure consequences of the immorality of circulation credit wreaks itself is through confusing and befuddling men *so that all their calculations are made erroneous and too optimistic.* The reality in the economic situation is no longer correctly appraised.

A return to a correct appraisal means a grave adjustment, known as a depression, before things can get back to "normal" again. The cause of the boom is the ultimate cause of the depression.

All liquidity which essentially depends on rising prices is a pseudo-liquidity.

The only kinds of loans bankers should make by using depositors' money is to borrowers whose ability to repay, whose liquidity, does not essentially depend on rising prices, but on uses where the turnover is naturally rapid and the need temporary. A liquidity which disappears with the ending of rising prices is a treacherous and not a real liquidity.

The Credit Jam In The Great Depression Of 1931-1934

A friend returned to the office one day during the Great Depression and told of a problem he had heard discussed at lunch.

A owed *B* \$20,000; *B* owed *C* \$20,000; similarly *C* owed *D; D* owed *E; E* owed *F; F* owed *G;* and *G* owed *H.* The total of these debts amounted to \$140,000. And not one of these debtors could pay. *G* could pay *H,* only if *F* could pay *G; F,* however, could pay only if *E* could pay him, and so on back to *A.* If *A* could pay, then all could pay. Here was a jam of debts amounting to a considerable sum, just because the first man could not pay.

If, however, *A* could obtain $20,000, then presto, within an hour of time $140,000 of debt could be liquidated.

The question posed was this: why not get rid of this mountain of debt — $140,000 — by helping the first man in some way pay his $20,000 debt? But how do so? *Who* would provide him with $20,000?

Well, if *A* could not or should not be helped, how about washing out all the intermediate debtors and creditors, everybody from *B* to *G* inclusive, leaving only one debt left, namely *A*'s $20,000 debt which he would now owe *H*? However, *H* might not agree. He might not wish to relieve *G* of his debt to himself (*H*). *H* might consider himself left with the least-able-to-pay debtor in the series, the first man *A*. *H* will say to himself: "One of the rest in the series may some day be able to raise the $20,000, and then I can be paid. I do not wish to rely on *A* only."

But in any event, so the argument went, is it not folly to force seven men through bankruptcy when there is only one "culprit"? Why not help the first man in the series and save the other six from the same fate?

Then the situation was generalized in this manner: "It is because there are a lot of cases like this that the country is currently debt-ridden, and we are frightened about it; if only we could get rid of the 'multiplication' of the debt by dealing only with the ultimate debtor and the ultimate creditor, then we could solve our problem."

By this type of reasoning, it was believed, that a major contribution could be made to solving the depression problem of the early part of the 1930 decade.

The proper answer to these proposals is left to readers, who may prefer to work in their own way to "solve" this hypothetical problem. Let us here consider only the *origin* of the problem.

What probably was the origin? Almost certainly a series of debts of this kind would be the result of inflationism. Consider, as an example, the rising prices of farm lands in the inflation of 1915-1920: a farm may have carried a mortgage of $20,000; *A*, let us assume, owned the farm and owed the amount of the mortgage. How, probably, would a series of debts of $20,000 each arise as in the example posed? One way would be by the farm changing hands seven times, and each buyer assuming the mortgage. Each new owner, getting in his turn a higher price, would probably quickly reinvest his "profit" in still more land, or at least higher-priced land.

Maybe the farm had originally been worth $40,000. Recognize definitely that the price had gone up to $120,000. The difference between the $120,000 and the original mortgage had almost certainly been "used" and "re-used" by these investors (speculators?) in farm land. In rising markets people are reluctant to leave money idle. They rush into new investments.

But something had happened. The rise in farm land prices had stopped, and then a rapid decline had set in. All the "profits" had been wiped out by declining prices. The wealth each of these men thought he possessed had disappeared as vapor in the air.

And what was finally left to pay the $20,000 due on the mortgage on the land? Nothing but the farm itself, and just at that time the farm could not be sold to anyone for $20,000. Everybody might concur that the farm looked very cheap at $20,000, but nobody had the money, or at least nobody had the inclination just then to pay $20,000 to get the farm. In addition, all the men in the series were probably reluctant to have a general "settlement" at the prevailing depressed level of prices. They probably said to themselves, "Before that boom started the farm was worth $40,000. Sombody once thought it was worth even $120,000. Surely, it is worth more than $20,000." And so everything remained "paralyzed" without any settlement being made.

One thing is certain: the debt jam described was caused by falling prices; and equally certain, the debt mountain was originally piled up on the basis of rising prices.

Those rising prices, in turn, were caused essentially by *circulation credit.*

Are Bankers The Men Who Cause Depressions?

In a sense, bankers do cause depressions. They "cause" a depression when they become "alarmed" or "prudent" about the business situation, and, as their first reaction, cease putting out more circulation credit; and then, when still more alarmed, insisting on a reduction in outstanding circulation credit.

The earlier increased circulation credit which they had put out had operated like additional money, and had caused rising prices (according to the quantity theory of money). As certainly as more credit stimulates price increases, just as certainly a reduction in credit induces a price decline.

And so, bankers are the "cause" of booms and depressions, because they vary the amount of circulation credit. But really it is a grave injustice to bankers to make the charge against them that *they* cause booms and depressions. Everyone admits that bankers, as a group, are as honorable as any group in the country. They are most highly respected and properly so.

If bankers are not to be blamed for varying the quantity of circulation credit, who *is* to be blamed? The public, the citizens of the United States.

The banking laws of the land are the laws that the citizens want. Bankers merely react as anyone would react to the laws under which banking must be conducted. Change the law and then bankers will operate differently.

Bankers, however, should acknowledge a special responsibility. They ought to educate the public to the folly of the present banking law of the country. This is the "field" in which bankers are experts. They ought, therefore, to be in the front ranks of those who are endeavoring to end the issuance of circulation credit.

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