FIRST PRINCIPLES
IN MORALITY AND ECONOMICS
on which depend personal well-being and social health and harmony
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A Man Who Taught That Business Is Solely For Profit

An associate, who was also a professor at a famous midwestern university, was accustomed to tell, as a fit subject of amusement, the various answers his students gave to his questions: "Why is a man or a company in business? What is the purpose?"

The answers, he would relate, were of all kinds: (1) to in-

crease production; (2) to supply men with what they needed to survive and to be comfortable; (3) to provide employment for those who needed work; (4) to provide for self and have a surplus for charity; (5) to devote one's life to service for others; and a surprising number of additional reasons for being in business.

The questioner was a self-made man and rugged individualist. He was born on an unproductive farm in the south-central part of the United States. As a boy he had rebelled against farm work and the living conditions in his home. In defiance of parents he had packed his few belongings and left for the "city". Hard years followed — of poverty, privation, disappointments. But these had all been surmounted by hard labor, driving ambition and an iron will. He was now a business "tycoon" with a large income and great influence. If, as was often the case, he had worked far into the night at his regular business, it was nevertheless his invariable practice to be at the university at seven the next morning on his lecture days to teach a class in business problems. This teaching activity was in a sense a labor of love. The money he received for it was a small part of his income. But he had a "compulsion" to teach to others what he had learned himself. And so he continued to teach, despite the steady drain that it was on his strength; he died before he was 50 years old. Obviously, he was a man of mixed make-up; aggressive, but with a strong streak of idealism in him, making him willing to exhaust himself to teach others whatever he had learned that he considered of value.

This was the man who was asking the question: "What is the purpose of business?" This was the man who was relating with ridicule the type of answers which he was given. Then he would bring his story to a climax by saying that he always told his class of students: "The sole and only purpose for being in business is to make a profit."

How be reconciled to the fact that good business men concentrate intensely on making a profit, and without compunction express

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their objectives in those terms. Is there a connection here between selfishness (the wish for profits) and success; and is there no connection between idealism and success? Especially, if a man has idealism about *serving his neighbor,* and thereby presumably showing "brotherly love", does that mean he is likely to be a failure in business? Can a man, in fact, have his goal set solely on making large profits, and still be serving his neighbor?

The problem can be stated in this manner: how reconcile the objective of serving one's neighbors with the objective of making a profit?

It Is Maladroit To Say That The Sole Purpose Of Business Is To Earn A Profit

Although the expression, *The sole purpose of business is to earn a profit,* is an admirable and to-the-point formulation, it is nevertheless an unfortunate one. We agree wholeheartedly with the idea, but deplore the words in which it is expressd. It is very maladroit, considering the way most people will interpret the statement.

It will sound to them as if the speaker is shamefully selfish. Many people will suspect that he aims to be successful *at the expense of other people.* It sounds almost as if a man who says, the sole purpose of business is profit, is also in effect saying, the devil take the hindmost, and what do I care about how anybody else gets along. Actually, the expression, when used by a business man who has a comprehension of the real business structure, does not mean that he intends to get a profit from his business activities by means of exploiting other people, or by being indifferent to their welfare. There will *never* be a profit, in a free economy, for a business man who is indifferent about serving his fellow men. In a free economy, the only road to profit is exclusively via the road of service.

How then should the "idea" encased in the expression, the sole purpose of business is to earn a profit, be better formulated? This is the way we would express the identical idea: *the purpose of business is to serve independent customers so well that they voluntarily and actively will wish to buy from you, which will be evidence that they consider it is beneficial to them to do so, which in turn means that your selling prices are in-line or low, that your*

quality is good, and that your product functions as well or better than competitive products. Further, if after serving your customers so well, you still make a profit, then that is evidence, in a free market for labor, that you are an efficient operator who knows how to muster labor and material so well that there was a profit left to you after paying the full market for material and labor. Your profit was the evidence, assuming free markets, that you were legitimately in business, that is, that you were genuinely efficient, because only those efficient enough to survive under free competition are legitimately in business. People simply rewarded you with a profit, because you were efficient in service to your fellow men; and they rewarded you in proportion to that efficiency.

Surely, a business man wants a profit, for more than one reason. He wants a profit from his personal self-regarding viewpoint, just as everybody wants what he can honestly get. There is nothing wrong about that. He wants a profit, too, because it sustains his morale. He knows that if he does not make a profit, he is, and will be known as, a blunderer in business. He does not wish to have that reputation. The blunderers miscalculate, lose money, go out of business.

Of course, none of the foregoing is true if there is not a *free* market. The phenomenon of profit is not evidence of service and efficiency when a society is either socialistic, communistic, or interventionistic; the "profits" of a business in such cases are controlled by bureaucrats; *they* are sovereign, and not the consumer. But where the free consumer is sovereign, and in a society where coercion is prohibited (according to the Sixth Commandment of the Decalogue), there *profit* is synonymous with *superior service to one's fellows.*

If anyone insists that that statement be qualified, then it might be thus: profit in a free society is equivalent to service to fellow-men, except in so far as fellow-men do not know their real interests or lack vigor to act in a manner to attain them.

But, in any event, "consumers are sovereign." They determine, by buying from you or abstaining from buying from you, whether you will be able to make a profit.

If there is anything in this world that is a reward for obeying the Sixth Commandment (which broadly means, Thou shalt not coerce), then it is profit.

Ludwig von Mises On The Present-Day Significance Of Knowing Something About Economics

In an article in *The Freeman* (published by the Foundation for Economic Education, August 1959) Ludwig von Mises has the following to say about the present-day importance of reading economic books and studying economic problems:

> . . . what about the general reader, the man who does not plan to specialize in economics because his strenuous involvment in his business or in his profession does not leave him the leisure to plunge into detailed economic analysis? . . .
>
> To answer this question we have to take into account the role that economic problems play in present-day politics. All the political antagonisms and conflicts of our age turn on economic issues.
>
> It has not always been so. In the sixteenth and seventeenth centuries the controversies that split the peoples of Western civilization into feuding parties were religious. Protestantism stood against Catholicism, and within the Protestant camp various interpretations of the Gospels begot discord. In the eighteenth century and in a great part of the nineteenth century constitutional conflicts prevailed in politics. The principles of royal absolutism and oligarchic government were resisted by liberalism (in the classical European meaning of the term) that advocated representative government. In those days a man who wanted to take an active part in the great issues of his age had to study seriously the matter of these controversies. The sermons and the books of the theologians of the age of the Reformation were not reserved to esoteric circles of specialists. They were eagerly absorbed by the whole educated public. Later the writings of the foremost advocates of freedom were read by all those who were not fully engrossed in the petty affairs of their daily routine. Only boors neglected to inform themselves about the great problems that agitated the minds of their contemporaries.
>
> In our age the conflict between economic freedom as represented in the market economy and totalitarian government omnipotence as realized by socialism is the paramount matter. All political controversies refer to these economic problems. Only the study of economics can tell a man what all these conflicts mean. Nothing can be known about such matters as inflation, economic crises, unemployment, unionism, protectionism, taxation, economic controls, and all similar issues, that does not involve and presuppose economic analysis. All the arguments advanced in favor of or against the market economy and its opposites, interventionism or socialism (communism), are of an economic character. A man who talks about these problems without having acquainted himself with the fundamental ideas of economic theory is simply a babbler who parrot-like repeats what he has picked up incidentally from other fellows who are not better informed than he himself. A citizen who casts his ballot without having to the best of his abilities studied as much econo-

mics as he can fails in his civic duties. He neglects using in the appropriate way the power conferred upon him in giving him the right to vote.

Unreasonable Requests Addressed To Union Leaders That They Be Reasonable

Presently (August, 1959) there is a steel strike in the United States. Negotiators for the employers, and many people — some of whom speak for themselves and others who speak and write as if they were authorized spokesmen for the "public" — call on the negotiators representing the United Steelworkers of America to be "reasonable", that is, not to demand large wage increases and not to strike, all for the alleged reason that the union should not contribute further to the inflationism which has been continuing steadily in the United States.

This request to be "reasonable", addressed to the negotiators and the members of United Steelworkers of America does not appear, upon careful thought, to have real merit and it is hard to see why the Union and its leadership should heed it.

Recently three men were riding back from lunch to an afternoon meeting. The sales vice president of a heavy machinery company which consumes annually thousands of tons of steel was sitting in the back seat, and he was talking about the strike. This is what, in effect, he said: "I don't see how anybody can expect a favorable response from MacDonald [head of the United Steelworkers of America] to a plea that he be 'reasonable.' How long could any labor leader expect to survive who does not fight hard, using all means that the law allows, to get for his members everything that he can? Every union head who expects to keep his job must fight for all he can get, without paying any attention to general conversation about inflationism. If he does not follow the policy of getting what he can get, strike or no strike, he won't last long. Somebody else will get his job. When I imagine myself in MacDonald's position, I can't think of myself doing anything differently from what MacDonald is doing."

These were approximately the words of a business man adversely affected by the strike, and not the words of a union partisan. This man was sincere in his thinking and speaking. What he said appears to be sensible; it gets down to this: *if the law permits something to free men, they will surely do it if it is good for*

them or their group, even though it hurts society generally. If the law permits men to do what is wrong, but one man resists the temptation to exercise the power which he has to do wrong, he will be succeeded by someone who does not exercise that voluntary self-restraint to be "reasonable". When the law permits something, competition among men will insure that whatever is permitted will surely be done. If A *will not do it because he is "reasonable", then* B *or* C *or* D *will be crowding hard to do whatever the law allows, completely disrespectful of whether it is "reasonable".* It has always been that way, and it will always be that way.

MacDonald is a foolish man, if he does anything less than the law allows. If there is something wrong, it may not be the "reasonableness" of MacDonald or his United Steelworkers of America union, but it may be the law of the land which says what unions may or may not do; or, finally, it is poor enforcement of laws which MacDonald and the union might be breaking. The real trouble is not the lack of sweet reasonableness, but (1) the law of the land or (2) its enforcement. The citizens of this country should address themselves to that, and omit ridiculous preachment to MacDonald about "reasonableness."

Similar Unreasonable Propositions Addressed To Bankers By Themselves

When reading this article, the several things previously written in *First Principles* about money and banking should be kept in mind. To assist the reader we shall restate a few of them so that what follows will be more easily understandable.

There are various kinds of money, namely, metal money, paper money, token money, fiat money, credit money. If a bank extends *credit* to a customer, that means it supplies purchasing power to customers; credit is therefore an obvious substitute for money and has the same effect as regular money.

Secondly, under United States law (for the unwise purpose of making money more plentiful), banks are permitted to put out as much as five times as much new credit as their gold reserves increase. This special privilege of the banks, permitting them to "create" five times as much money as they increase their gold supply, means that there is a terrific leverage from changes in the gold supply, either up or down.

This five-fold leverage, which is "organized" into the United States banking system, is the source of that systematic disorganization of business, which is known as the business cycle, or booms and depressions. We are describing phases of the process, as simply as possible, in a general

analysis which indicates that there should be changes in the money and banking laws of the country.

Bankers have sometimes admonished themselves, just as moralists sometimes admonish labor union leaders. Such bankers admonish themselves in this vein:

> We should, of course, make all the loans to business that we can. That is our function. The money to make these loans comes in part (1) from our capital and from savings deposited with us or from balances left by depositors in their checking accounts; and in part (2) from fiat credit — credit which we "create" as out of thin air — resulting from our special privilege which permits us to manufacture credits in the amount of five times any increase in our gold reserves; if we get $1,000 more of gold (which we will deposit as additional reserve with our Federal Reserve Bank), then we may — if we wish — increase our loans $5,000.
>
> Our problem is to make as much money as we *safely* can. We, therefore, want to loan pretty freely. If we get more gold, we must put that resource to work as soon as possible by loaning (or investing) five times as much. If we do not do that, then the business will go to competitors. They will expand their loans — credits which they make available to borrowers — more than we will. They will make a bigger profit than we will make. We will appear to be unsuccessful bankers and they will appear to be much more competent. But we must be careful not to increase our loans *too much*. We should not increase them so that we *overdo* it. We must exercise self-restraint, too.

This is exactly the same kind of "solution" to banking problems as would be applied to labor problems today, if we permit proposed labor reforms to be nothing more than to tell labor union leaders to be better men and to let the labor laws stand unchanged —labor laws which permit labor leaders to do these very things that are bad.

The trouble with the banking situation is that the laws governing banking are as deficient as the laws governing labor unions. They are both, in fact, intolerable.

The Remorse Of Big Bankers In 1908

As we have reported earlier (in the November 1957 issue), many years ago the writer had occasion to go to the local Federal Reserve Bank, to ask permission to examine certain old financial magazines. He wished to read them as far back as the year 1900. He had tried other libraries first and had been told that the magazines, if available at all, would be in the library of the Federal Reserve Bank. Upon inquiry at the bank, he was readily accommodated, except that none of the publications were available prior to 1908.

The year 1908 was the year following the banking panic of 1907, a year in which the banks had been unable to meet their obligations and many of them had failed. Those who survived had done so by creating a temporary money, known as Clearing House Certificates.

The magazines in question were in 1908 full of honest and upright self-examinations, confessions and self-incriminations, by bankers. Some of the articles in the magazines were written by outstanding bankers of that day. Or the articles told about some conference of bankers at which several had made speeches analyzing why the financial disaster of 1907 had occurred. With obvious sincerity they all *blamed themselves.* This in effect is what they said:

> We loaned *too much.* We extended *too much* credit. We should have exercised more self-control. If only we had not loaned so much, there would not have been a depression, much less a crisis, and certainly no panic. We made a mistake. We ought never to make the same mistake again.

Their sincerity about all this was obvious, and they were as contrite as a sinner coming down "the sawdust trail."

But they did not, in the articles we read, condemn the *system* under which they had operated. They condemned themselves only. That was good as far as it went, but it did not go far enough. They should have been more fundamental in their condemnation, namely, they should have condemned the basic premises of the banking system under which they had been operating.

The Problems Of Banks: To Be Profitable And Liquid

A description of *everything* that would take place if a person engaged in the banking business in the United States would be difficult to understand, especially if the description outlined all of the features and details of present-day banking law. What follows is instead a schematic description designed to reflect the monetary and banking *principles* involved, so that the average layman will obtain a general understanding of them, rather that a precise and complete technical description.

Imagine deciding for yourself that you will be a banker. If that would be your goal, these might be the steps in the program that you would take.

Step I

As a banker, you would invest, say, $100,000 of your own money in a commercial bank.

Next, you would ask others to deposit their money in your bank. Maybe they would put in $500,000 and open checking accounts. You have then $600,000 with which to work. Your bank will have expenses, as rent for banking quarters, salary for a teller, light, taxes, remuneration for yourself, etc. Further, you ought to get a 5% return on your investment of $100,000, or $5,000, because income from capital is in the nature of things. Rent would be, say, $5,000 a year; teller, $5,000; salary for yourself, $6,000; miscellaneous expenses, $4,000; and a $5,000 return on your investment. The total of that is $25,000.

Step II

You will wish to put the $600,000 to work quickly. The thing to do is to loan it. If you loan every dollar of it at 5%, you will have a return of 5% on $600,000, or $30,000. Your "costs" (including a 5% return on your investment) are only $25,000. You have, under this assumption, an *extra* profit of $5,000. If this was the real character of the banking business, then it would be a nice business to be in.

Step III

But the assumption in Step II is unrealistic. People do not have checking accounts in banks, except to have money available *whenever they want it.* You, as a banker, cannot loan the money to third parties, if your depositors have placed their money in your bank for the sole purpose of having it reliably available to draw on whenever they need money. They wish to have their money available *on demand.*

If that is the case, it might seem to follow that it is not safe to loan any of the money to third parties, unless it is loaned to third parties who will make a contract to pay back immediately on your demand. Few borrowers will want loans which must be repaid *on demand,* that is, whenever the lender (in this case your bank) must have the money back, so that the depositors of the bank can use it themselves. Gone then is most of the $30,000 of theoretical earnings figured in Step II. If *all* the $500,000 of deposits must be kept on hand, you can loan only your capital of $100,000 at 5%, or earn $5,000.

Compared to the $25,000 of costs which you should be able to cover, according to Step I, you are short $20,000. Who would want to be in the banking business, and lose money at that rate? Would you not give some thought to returning to your depositors the money which they had deposited, to cancelling your lease, and to putting your own $100,000 to work somewhere else?

Step IV

But after being in the banking business for a while, you do discover one thing, namely, although all your depositors want their money to be available *on demand,* and although now one and now another does draw out all of his funds, nevertheless *it seems* that *it never happens that all the depositors want their money at the same time.* You notice that although deposits fluctuate — sometimes over, sometimes under $500,000 — the amount of deposits never seems to go below $300,000. When you think it over, this appears natural and even probable. If *A* buys a house and must pay to *B* $5,000 for it, *A* may draw $5,000 out of his account, but *B* adds it to his account. One man's disposal of money means another man's acquisition of money. Money is never "idle" in a real sense. People wish to have money as their cash reserves against emergencies. Money can be looked upon as resting always in someone's possession. There is, indeed, a "circulation" of money, or a "turnover" of money, but money *always* belongs to somebody. It is either in *A*'s possession or *B*'s possession. The moment of transfer between the two is infinitesimal, and from this viewpoint can be looked upon as nonexistent in time. And so, there it is, always in your bank, unless (1) a depositor withdraws money in order to carry more in his pocket; or (2) he transfers funds to another bank; or (3) someone to whom he makes payment keeps the money

in his pocket or deposits it in another bank. But the money is always "resting" somewhere.

Having discovered that your deposits appear never to go below $300,000, you reach a major conclusion, namely, not only can you loan the $100,000 which is your own capital, but you can loan another $300,000 of depositors' money. You can now loan a total of $400,000. At 5% your income as a banker is now $20,000. That compares with your costs of $25,000. There is still no profit in your banking venture, but a loss of $5,000. Nevertheless, by "taking a chance" on loaning $300,000 of depositors' money, which they *seem* always to leave in their balances, you have cut your loss from $20,000 to $5,000. But, who knows, they *might* demand all their money some day!

It should, of course, be kept in mind that people can become frightened. The first thing they then do is they try to protect themselves by getting or holding tightly to emergency funds, that is, by having more cash. If a terrifically frightening event occurs, your depositors might make an unprecedented withdrawal. They might reduce their deposits to nothing, or rather *try* to do so. They could not, under the circumstances assumed, do that. The cash would not be there, because you have loaned out $300,000 of their money. When they begin to draw out and continue to draw out cash, you will be sitting anxiously in your bank office hoping that the special withdrawal will end. But there are still depositors who want $200,000 more. What can you do? You could go out on your bank floor and talk to each of them like this: "Mr. Smith, I have loaned out $300,000 of the depositors' money to borrowers who needed money. They will pay me back soon, at varying dates, depending on when their notes are due. Would you please wait another 60 days or a half-year?" But Smith and the other depositors may be frightened. They may say: "Mr. Banker, we understood we could *always* get our money when we wanted it. If we had not expected that, we never would have put our money in your bank. We *must* have our money, *right now*." If the borrowers, whose notes come due from time to time, pay their notes on time, you will be able *finally* to pay out your depositors.

At the moment that you are unable to pay you are at least *nonliquid*, and if many of your borrowers do not pay you, your bank may be *insolvent*.

To make the distinctions between being nonliquid, insolvent and bankrupt will be helpful in explaining the problem.

To be *nonliquid,* and nothing worse than that, means that what you own is worth more than what you owe, but nevertheless you are unable to pay because your debts come due sooner than you can convert your assets into cash with which to pay your debts. To be nonliquid is always distressing to honorable people, and very frequently brings on bankruptcy. The reason is that alarmed creditors do not wish to wait for an orderly and maybe slow conversion of your assets into cash. Because they need the money, or because they are alarmed, they may insist on so fast a sale of your assets that the prices you get for them are less than their real worth. At first, you may have been merely nonliquid, but you may end being insolvent and bankrupt. To be nonliquid is always to be suspect, and consequently a nonliquid condition is very dangerous.

To be insolvent means that your debts really exceed your assets; you have *no net assets.* Nevertheless, it can happen that you will not, although insolvent, go through bankruptcy. Your creditors may give you time, and by hard work and thrift you may be able to accumulate an amount equal to as much as your debts exceeded your assets, and so pay off the debts.

To be *bankrupt* means more than that you are insolvent; you may see no hope to pay your creditors fully, and/or they mistrust it; you ask for bankruptcy proceedings and/or they demand it; your creditors are then all paid proportionately, but not the full amount (unless they are secured creditors in which case they get more); and you are then declared free of obligation to pay the remainder. Your name has, however, a stain on it. You have been a bankrupt.

A bank, to do well, must retain the reputation of being liquid, as well as being solvent. The mere fact that your bank might not be able to pay one depositor his money, *on demand,* will be disastrous for your bank. That depositor will surely talk about it.

For a bank to retain its reputation, it is as necessary to be "liquid," as it is for a woman to be virtuous. The breath of suspicion is ruinous. Depositors who do not need the money and had not intended to take it out will at once demand their money if they come to have doubts. There will be a "run" on your bank.

To restrain banks from following policies which will result in

their being *nonliquid,* laws have been passed prohibiting commercial banks from making certain kinds of loans, that is, loans not due for repayment until a long time in the future. Obviously, the longer the time the loans made by a bank are not due to be repaid, the less liquid that bank is. Bankers, too, pay attention to "spacing" the maturity dates of loans they make, so that regularly some loans come due. By spacing and by being restricted to *short-term* loans, commercial banks are kept *relatively* liquid.

But in a sense, every bank is in part unsafe, namely, in so far as its obligations to pay are *demand* liabilities, that is, are depositors' claims due *on demand,* while simultaneously assets are invested in loans which are not all due and collectable *on demand* of the bank. Every commercial bank which has all its liabilities due on demand, but not all its assets are due on demand (or if due on demand in theory are not collectible on demand in fact) is vulnerable, and is in a sense courting trouble in times of emergency. (Banks have some "reserve", of course, in the form of capital, undivided profits, and surplus.)

Step V

But, as if your problems as a banker were not great enough, in emergencies, in the form of the potential demand for immediate repayment of *all* of the deposits, what would you think of increasing the risk still more?

Suppose the law permitted you to put out five times as much money as you have gold in your bank (or, more accurately, in your Federal Reserve Bank). Let us assume that you have taken your $100,000 of capital and put $80,000 into gold and $20,000 into bank fixtures. On the $80,000 of gold, according to the laws of the United States, you could make $80,000 x 5, or $400,000 of loans. The law does permit you to do that, and let us assume that you acted according to that permission. Your situation in regard to income-producing assets would then be:

1. Your own assets ($100,000-$20,000) x 5, equal to	$400,000
2. Depositors' money in the amount of $500,000, less $200,000 for "fluctuations in their balances," which means you can "safely" (?) put to work only	$300,000
Total potential working assets	$700,000

Now, if you get 5% interest on the $700,000, your gross earnings will be $35,000. Subtract from that the $25,000 "costs" as previously computed and you have an *extra* profit of $10,000. Finally, your bank has become profitable.

Let us proceed with the analysis. Originally, you as banker "contributed" $100,000 to the supply of funds. You must have obtained that in some way — by inheritance, by work, by saving, by borrowing from a friend — at least somehow. You parted with $20,000 of it for furniture and fixtures. That left you the $80,000, which you invested in gold. Then you "created" $400,000 of deposits. That was done something like this: Mr. Andrews comes in and wishes to borrow $20,000. You agree to loan him that amount. Where does the $20,000 come from? Your own capital is "tied up" in furniture and fixtures, and in gold. You simply ask Andrews to sign a note of $20,000 and you take Andrews' bank passbook and post there-in a deposit credit of $20,000; you give him a check book; he can draw out the $20,000 as he needs and wishes. To "balance" the $20,000 on your books you show on your books an "asset", consisting of $20,000 owed to you by Andrews and evidenced by a note. This loan to Andrews is in the form of a *deposit credit.* It is equivalent to money in the markets in your community.

Andrews can spend any or all of the $20,000. Usually, he is expected to "keep a balance" of one-fifth the amount of his loan; in this case that is $4,000. If he observes that rule, he can spend $16,000 of the $20,000 he has borrowed. That "money" is "new" money for all practical purposes. Andrews buys like any other buyer, and when he does so, he affects business as other buyers do. But there is nevertheless a fundamental difference. There was *no production on Andrews' part antecedent to his buying.* He is a "new" buyer, a man who comes in with the exact equivalent of counterfeit money (except that the law allows it, and that the public believes that this kind of counterfeit money makes for general prosperity, whereas nobody believes that the practices of regular counterfeiters contribute to prosperity).

Counterfeiters have not found the way to produce counterfeit money half so easily as the banking system, as just explained, permits counterfeit money to enter the buying stream. Counterfeiters must laboriously (and secretly) print counterfeit bills. But, in the case just explained, all that is necessary is for a user of the banking

type of counterfeit money to sign a note for $20,000 and for the banker then to give the man a bank passbook, post the date in it, and the figure of $20,000. Presto! There is $20,000 of "counterfeit" purchasing power, created so easily, so legally, and blessed with so much community approval and praise, that everyone who understands what has really happened should be astonished. The world is really upside down!

Step VI

What you do for Andrews you can do for others until your total of $400,000 of "counterfeit money" is exhausted.

In a sense your $400,000 is not all "counterfeit." There is behind it $80,000 worth of gold. That gold could have been used for money and so the counterfeit amount is really $320,000, as far it affects business. The amount, however, that you as banker have available for disposal is the full $400,000. How far you go in loaning it depends on your discretion. You know there is that limit in the total — $400,000. Once you have loaned out the $400,000 you must stop. Any late comers for some of the purchasing power which you have "created" will have to be told regretfully that there are no funds available anymore, (unless some of the older loans made by you come due, and are paid off, and you can re-loan that amount). The *surge* of loans that you could make is over as soon as you have utilized the whole amount obtained by multiplying your reserve of gold by five.

That surge had an effect on business of significant proportions. There was $400,000 of purchasing power in the form of new bank deposits added to the $500,000 that the townspeople had already put into your bank. They originally had $500,000 in the form of bank deposits, with which to buy. If your $400,000 is added to it, the amount is $900,000 of monetary purchasing power. Such an increase will have some big effects in your city.

There is no reason whatever to expect that there will be an increase in prosperity from this increase in money. A country does not become rich by borrowers signing notes at a bank, and the banker posting $20,000 (or whatever the amount of the loan is) in the passbook of the borrower. It would be ridiculous to think that prosperity could be created in that manner.

The borrower can go out and use the $20,000 to buy capital goods, consumer goods, or go on a wild spree of debauchery. But

society is not richer by his *consumption,* and he becomes a consumer of something, by the use of your money, before he can become a producer. (Whether the borrower uses the $20,000 for one purpose or another will have an effect on the welfare of society; a wise expenditure will give better consequences than an unwise expenditure, but some of the remote consequences of that are beyond the present analysis.)

The fact of importance at this time is that the borrower himself benefits from getting this purchasing power, and that during the current situation his *fellows are correspondingly injured.* That has been explained in earlier issues. When fiat money of whatever kind is made available, the *first* users are the principal beneficiaries of that new money, because they intrude into the buying of existing merchandise, at the old prices, which do not reflect the enlarged money supply. There is, as Hume recorded long ago, only one sure effect from increasing the quantity of purchasing power — not increased prosperity or wealth — *but only higher prices.* Those higher prices do not occur equally and concurrently but variably and in sequence. The *second* users also gain from the new money, albeit less. And so on. The later and especially the last users of the new money are unqualified losers. They do not get the *extra* quantity of purchasing power which has been made available until everybody else has preceded them. These last users, in the meanwhile, have been selling their products and their services at the old prices or at laggard prices. They have been buying more dearly all the time because the early users of the new money were bidding for goods, but they themselves did not yet get hold of some of the extra or new money to enable them themselves to bid higher. In short, what the early users of the new money obtained as an advantage, the later users lost.

The over-all consequence of the new fiat money, in the form of *deposit credits as explained,* is that some gain at the expense of others, *temporarily.* Eventually, the consequences permeate through the whole economic structure. All prices are then higher. But *in the meantime there have been great inequities perpetrated between individuals.*

The outstanding conclusions that can be reached are that you as a banker have increased the quantity of money in your community, have benefited your direct borrowers and other early users of

your money, have hurt all the later users, and that prices are generally higher, but that the community has no more real prosperity than it would have had if you had not created new money in the form of deposit credits. By your new money, you have *altered* but *not improved* the economic aspects of your community. Further, you have made a profit for yourself by "creating" money in your banking operations. You and your borrowers were the gainers to the hurt of the rest.

(Some may argue that the fiat money you created will turn out to be a form of "forced savings", from which society will benefit. But so-called "forced savings" are only one of several potential consequences of your putting out new money. But in any event, it is not correct that "forced savings" have certain effects as some people think. It is not feasible to digress here to consider the merits or demerits of "forced savings".)

Step VII

But you yourself will have some special problems as a banker, which derive directly from your practice of putting out new money in the form of *deposit credits.*

If some disaster happens and your depositors suddenly want their $900,000, you will be unable to pay them. According to our assumptions, you would have $20,000 in furniture and fixtures; $80,000 in gold in the vault of your Federal Reserve Bank; $200,-000 in cash in your bank quarters; $300,000 of loans made with depositors' funds; and another $400,000 of loans with " created" funds. (A phase not covered here is that some of the loan amounts would be left in cash balances.)

You would pay out your $200,000 which is in cash to those first in line to take out their money, but what about the remaining $700,000 you would need? You could not pay that out to your depositors except over a period of time — namely, the time that must elapse before the last borrower's note comes due. If you loaned some man $10,000 which will not be due until two years hence, the last of your depositors may have to wait for *two* years. (In this calculation no allowance was made for your own $100,000 of capital.)

* * *

What conclusion can be reached? There is almost never a *wholly liquid* bank in existence. Nevertheless, people expect banks

to be liquid. And in normal times, under reasonably good management, banks are "liquid." But in abnormal times, the banks as a whole — the system of banks — have *always* been found not to be liquid enough.

Somebody must then come to the relief or rescue of the banks; a moratorium is openly declared; or the banks are temporarily actually closed down; or "temporary money" is created in the form of Clearing House Certificates; or a Central Bank is authorized to manufacture new money for the emergency (maybe without a burdensome charge, or maybe with it).

This not-adequate-liquidity of banks derives from two factors:

1. Checking accounts are on the basis of being able to withdraw money *on demand;* but the assets, into which a bank is under inducement to invest deposit money, are *not* equally convertible into cash *on demand;* and

2. This is aggravated by banks being authorized to loan as much as five times the gold they have deposited with their Federal Reserve Banks.

* * *

What causes a depression?

1. The demand of depositors to have their money so that you as a banker are obliged to reduce your loans for that reason. Your borrowers must then pinch in their operations. They are unable to operate on the scale that they have been operating.

2. The consequence of the foregoing is a change in the climate of thought, so that you as a banker want Andrews to pay back the $20,000 he borrowed in the form of a deposit credit; and your further reluctance to loan it out to anyone else right away. And so, the credit which you manufactured and which was at that time an artificially favorable factor increasing "demand" for products, has now become a grievously unfavorable factor reducing such demand. Once there was a boom, created by the creation of manufactured credit; now there is a depression correspondingly caused by the liquidation of manufactured credit.

Commodity Credit Versus Circulation Credit

If a person seeks to understand the effect of certain modern banking practices on the money situation, and consequently its effect on the business cycle, then it is necessary to distinguish between:

> 1. On the one hand, the credits (or loans) which a bank extends (a) *by using its own capital, or* (b) *by re-loaning money which depositors have put into the bank;* and
>
> 2. On the other hand, the credits (or loans) which a bank extends because it is in possession, according to United States Banking Law, *of the special privilege to loan five times as much as the amount of gold in the so-called Reserves which it has placed in the vaults of the local Federal Reserve Bank, under which it resorts.*

In other words, it is necessary to distinguish between: credits, that is, loans granted, which your bank makes out of the $500,000 of actual deposits, in our illustration in the foregoing article; and credits in the amount of $400,000 which are "manufactured" by the bank, as also explained in that article. All thinking about money and banking is confused unless these two kinds of credits or loans have different names and are carefully distinguished.

What does not have a name cannot be understood. An evil that does not have a name, cannot be fought against. If different types of loans have only one name as loans; if different types of money are never differentiated and are nothing more than money in general — then no thinking of money, banking, or the business cycle can be highly profitable. It is therefore necessary to distinguish between kinds of credit and between kinds of money. Only then can the cause of the business cycle be understood, and can the cause be removed, or at least reduced to proportions so that public policy is no longer dominated by terror that there will be a depression.

To distinguish between the two kinds of credit that we have described, which are fundamentally different, we shall employ the terminology of Ludwig von Mises, as given in his earliest book on money and credit, entitled *The Theory of Money and Credit* (Yale University Press, New Haven, Connecticut). Mises applies to those loans by banks, which consist of the use of their own capital and the deposits of customers, the term, *Commodity Credit;* and he applies to loans by banks, which consist in exercising their special privilege of manufacturing loans equal to five times their gold reserve, the term *Circulation Credit;* it is the *Five Times Privilege* which is the origin of Circulation Credit.

We quote Mises briefly:

> Credit transactions fall into two groups, the separation of which must form the starting point for every theory of credit and especially for every investigation into the connection between money and credit and into the influence of credit on the money prices of goods. On the one hand are those credit transactions which are characterized by the fact that they impose a sacrifice on that party who performs his part of the bargain before the other does — the foregoing of the immediate power of disposal over the exchanged good, . . . This sacrifice is balanced by a corresponding gain on the part of the other party to the contract, [who gets an] earlier disposal over the good acquired in exchange. (Page 264.)

The reason why Mises calls such loans a *commodity credit* is clear from his analysis, namely, the money used represents capital, and the *reality* of the transaction consists herein that the lender temporarily forgoes the use of his own capital so that another can use it temporarily. The capital that the borrower acquires is an offset to the capital which the lender relinquishes. In total there is no increase or decrease in disposal power over existing goods, merely a transfer. There is the reality of commodities behind this transaction, and consequently the term *commodity credit* is apropos.

Mises continues:

> The second group of credit transactions is characterized by the fact that in them the gain of the party who receives before he pays is balanced by no sacrifice on the part of the other party . . . In the kind of credit transactions [which have been designated as *commodity credits*] what is surrendered consists of money or goods, disposal over which is a source of satisfaction, and renunciation of which a source of dissatisfaction. In the credit transactions of the second group [which will be called *circulation credit*], the granter of the credit renounces for the time being the ownership of a sum of money, but this renunciation (given certain assumptions that in this case are justifiable) results for him in no reduction of satisfaction. (Pages 264 and 265.)

When the bank was loaning its own capital or part of its depositors' deposits which the depositors themselves were not actively using, the borrowers could become *substitute* buyers of goods but not really *new* buyers. But when the bank is also loaning what it "creates" because it has the *Five Times Privilege,* then all original owners who have power to buy will continue to do so, but the new borrowers are additional claimants for goods that exist. The loaner of the new purchasing power, namely, the bank, has not surrendered a legitimate existing purchasing power to the borrower; it has granted new purchasing power which did not exist before.

The real "villain" in the monetary and credit situation is *circulation credit*. In a sense, there is nothing new about that idea that circulation credit is the villain. The idea that it is a "villain" in more than one hundred years old. Critique, therefore, of circulation credit is not critique by a "money crank."

Peel's Bank Act In 1844 In Great Britain

In earlier articles in this issue attention has been given to those deposit credits which are based on the Five Times Principle. The reason for singling out deposit credits *of that kind* is because it is this type of deposit credits which is unsound but prevalent today in the United States and elsewhere.

By *deposit credits* we refer to the transaction by which a borrower goes to a bank for a loan, and although the bank has no money of its own to lend or unused depositors' money, it nevertheless makes the loan because it has the right to grant credits equal to five times its gold reserve. We have used the illustration of a man borrowing $20,000 by signing a note, and the banker posting on the borrower's passbook a credit of $20,000, against which the owner of the passbook could draw checks as long as the money lasted. Today such deposit credits are the principal device by which banks in the United States grant circulation credit.

In England, in the early part of the nineteenth century the device by which to accomplish the objective of circulation credit was different. The device then consisted of issuing *bank notes*, rather than posting a credit in a passbook. In those days the borrower might enter the bank, ask for a loan, be granted the loan although there were no funds there in a commodity credit sense; the banker would take the man's note for $20,000, and give him in place thereof a kind of money (in appearance like ordinary paper money), printed by the bank and known as *bank notes*. In those days, borrowing was principally conducted by means of such bank notes, rather than deposit credits and checks. The deposit-check system was, it is true, beginning to be developed at that time, but was of trifling importance compared with the bank note system. It will be obvious that bank notes and deposit credits are merely two different manifestations of one and the same thing, circulation credit.

In the early part of the nineteenth century the merits and demerits of *circulation credit* were actively debated. This great de-

bate is known as the controversy between two schools of thought, one known as the Currency School and the other the Banking School. In this controversy the currency school was essentially right and it won out. It was able to get its views incorporated in that famous piece of banking legislation known as Peel's Bank Act, enacted by the Parliament of Great Britain in 1844. (The official name is Bank Charter Act.)

The enactment of Peel's Bank Act was an event of major significance in monetary history. The Act prohibited the further issuance in Great Britain of the then prominent type of circulation credit, namely *bank notes.*

What did Peel's Bank Act do and fail to do in regard to circulation credit (1) in the form of bank notes, and (2) in the form of deposit credit against which a customer could write checks?

The Act prohibited further increase of circulation credit in the form of bank notes. It froze the amount of bank notes already outstanding. It did not deflate the existing circulation credit in the form of notes by demanding their withdrawal. The mischief had already been done, and there would be acute problems, if the existing circulation credit in the form of bank notes would be reduced. But it banned *additional* circulation credit by the issuance of *more* bank notes.

Obviously a circulation credit in the form of a deposit credit against which the borrower can draw by writing checks, rather than by using bank notes, is just as much a circulation credit as bank notes. To have been consistent Peel's Bank Act should have prohibited an increase in circulation credit in the form of deposit credits just as definitely as it prohibited an increase in circulation credit in the form of bank notes. But Peel's Bank Act did nothing of the kind. It left the further increase of circulation credit in the form of deposit credits unrestricted. This was a glaring inconsistency and weakness in the Act.

The consequences were as follows:

1. The British banking and credit structure was relieved of a great weakness, the improper privilege of creating circulation credit by means of the issuance of additional bank notes.

2. Nevertheless, in order to grant and to obtain circulation credit, but in a different form from bank notes, the bankers and borrowers respectively turned to deposit credits as a substitute for

bank notes, because such deposit credits were not prohibited.

The evil of circulation credit in one form was arrested by Peel's Bank Act, but in another form was left unmolested. Naturally, the evil took the road which was still open to it and the increase in circulation credit was thereafter in the form of deposit credits.

Peel's Bank Act was therefore an Act of great strength, like as by a Sampson. But, like Sampson, it had a great weakness, which undid its strength.

The victory of the principles of the Currency School was not a decisive victory. It did not end the proper war against circulation credit. It was merely a successful battle on one front. An advocate of the Currency School who thought that the ban on further expansion of bank notes would end the expansion of circulation credit was a dangerous somnambulist in questions of money and banking. Having won the battle on one front of current importance, Peel's Bank Act proceeded to lose the battle on a front which at that time was of minor importance, but which was to become of overshadowing importance.

A Bank Law For The United States Patterned After The Famous Peel Bank Act

There are many "cranks" or "screwballs" in the world, on all kinds of subjects.

People who are critical of the established order in some way or other, are widely suspected of being cranks or screwballs. One way to dismiss the critique of such people is to sneer at them and "smear" them as cranks and screwballs. But the practice of "solving" problems by calling someone a crank or screwball requires discrimination, or else valid critique will be neglected.

The world has a goodly number of *money* cranks. One might be persuaded to believe that most of the people of the United States are today monetary cranks and screwballs, for various reasons, of which an important one consists in their favoring the continued issuance of more and more *circulation credit.*

If the game becomes one of name-calling, we, too, are as exposed as others are to being called money or credit cranks. What is our position?

We are against circulation credit, regardless whether it is in

the form of bank notes or of deposit credits. We, therefore, favor for the United States the equivalent of the Peel Bank Act, that is, a modernized version for this country of the real import of the Peel Bank Act in Great Britain 111 years ago. To accomplish that end, we would be pleased if a law were passed which:

1. Froze existing *circulation credit* in the United States, whether in the form of bank notes or deposit credits, at the present level, and prohibited any *further extension* of either form of circulation credit (except with temporary exceptions recorded in number 2).

2. We would make this exception, namely, we would first compute the *average increase* in circulation credit in the latest two years, and then we would permit:

   a. An increase of circulation credit of 85% of that average in the first year following;
   b. 65%, in the second year;
   c. 40%, in the third year; and
   d. 15%, in the fourth year.
   e. But thereafter none: the "freeze" would be absolute, and presumably in perpetuity.

In other words, we would "shock absorb" the proposed cessation of the issuance of circulation credit over a four-year period. (See the next article.)

Is this proposal a "screwball" proposal? Not unless the basic idea underlying Peel's Bank Act is basically a "screwball" idea. Peel's Bank Act, however, is a highly respected piece of monetary legislation. What is here being done is no more than applying to the American banking situation presently what the Peel Bank Act applied to the British situation more than a century ago (although it is admitted that the Peel Act was partially ineffective, because it was not *foresighted* in seeing that *deposit credits* were potentially of far greater importance as forms of undesirable circulation credit than bank notes).

In one respect, the proposal here made is more compromising than Peel's Bank Act, namely, in the paragraph numbered 2 there is a suggestion to permit the issuance of *additional* circulating credit, but in rapidly decreasing amounts. This is, maybe, a dangerous suggestion, but it is submitted for consideration.

An Endeavor To Escape The Moral Law

The world is full of people who think that they can escape the consequences of the "moral law." Maybe suggestion number 2 in the preceding article is a case in point.

Moses taught differently. He said, "Your sins will find you out." Or, in other words, you can *never* escape the consequences of your sins (which are always follies) but will experience them in one form *or another*. You may be clever enough to escape the obvious and usual penalty, but a penalty will show up sooner or later in another form. You cannot "beat the game."

There is also a tendency to be complacent about violating the moral law, because we know there is often a *time lag* of the penalty, considerably after the deed. It is fundamental in human psychology to *discount* future good and future evil. One of the most profound ideas in modern economics is the so-called "discounting of the future." You can safely offer a man $1,000,000 a thousand years from now. It is valueless to him, because he will not be here to collect it. It is quite different if you put your hand in your pocket and give him $100 *now*. One hundred dollars today is worth much more to him than $1,000,000 a thousand years from now. There is, therefore, always a "discounting" of the future. Similarly, the consequences of sin are discounted depending on how far the consequences of those sins are estimated to be in the future.

If a man believes that smoking will cause his death tomorrow unless he desists from smoking at once, he will not smoke at all until the danger is passed. But the same man may be almost indifferent about certainly dying, at some unknown date in the vague future, because of his smoking.

This idea of discounting the future, which is so important an idea in modern economics, is an old idea in Scripture. Solomon long ago wrote:

> Because sentence against an evil work is not executed speedily, therefore the heart of the sons of men is fully set in them to do evil. Ecclesiastes 8:11.

The expression sounds somewhat archaic in modern ears, but the idea is that, if the penalty for violating the rules that make social life advantageous were instantaneous, there would soon be very little of such violation, but (unfortunately or fortunately?) the penal-

ties are delayed, and so, because men discount future penalties as well as future pleasures, men are pretty bad today and now; they "discount" the future retribution.

Now, although most of us know what Moses and Solomon taught, and which experience reveals every day to observant people, nevertheless we are beguiled by the idea that we may be able to cheat the moral law of its consequences. We cannot resist the temptation to be unrealistic.

And so, we are tentatively proposing some temporary wrong-doing, in the form of *additional* circulation credits: 85% of the recent average, for the first year; then 65%; then 40%; then 15%; but thereafter no more such wrong-doing.

And what is our justification for this, in principle, malpractice? We think that the *gradual* progress from evil to good, from dishonesty to honesty, will reduce the consequences, that is, in this case will reduce the shock to prosperity, much more than if we cut off monetary folly abruptly.

This country cannot genuinely escape the consequences of having been putting out more and more circulation credit over many years. Everything is "geared" to continuing that malpractice. (We may be able to develop this important idea at a later date.) Some people are actually prospering by that malpractice, because they understand the game that is being played. But change the rules of the game, and then the players will change their policies at a rate dependent on their astuteness. There will be turmoil, confusion, faltering, miscalculation — *and a depression* of some kind. The reaction to that will be bad, because people will feel justified in being deterred from reforming, because the transition from evil to good is painful, and has some penalties which appear to come from becoming good, but which are really the *belated* consequences of the earlier evil.

The United States will *not* be able to make the transition from the dishonesty of circulation credit to the honesty of a stable and sound money supply without serious transition difficulties.

And so, hopefully and optimistically, but against better judgment, we propose a *gradual* adjustment to the discontinuance of putting out circulation credit. We are proposing giving men four years in which to adjust.

The Quick, Abortive End Of A Sound Eisenhower Credit Policy

In the United States the Democrats were in control of the administration from 1932 to 1952 — for twenty years. The Democrats do not have the best record in regard to favoring sound money policies.

Eisenhower, when he came into office in 1953 was the first Republican president in twenty years. It is implied in the nature of the case that a party out of power is critical of what the party in power is doing. And so Eisenhower was elected on a "sounder" or less-unsound money policy than the Democrats had been following.

The policy originally adopted by the Eisenhower administration was not a completely sound policy, to wit, an announced, fixed policy *of no further extension of circulation credit at all,* but rather a slowing up of the extension of circulation credit.

Eisenhower appointed an experienced business man as Secretary of the Treasury, and as Assistant Secretary appointed a veteran banker, who undoubtedly realized fully the ultimate consequences of a continuation, without a terminal point, of the issuing of more and more circulation credit. The technical steps necessary to slow down and end the issuance of more and more circulation credit are outside the bounds of this discussion, but those technical steps were promptly and effectively applied by competent people in the new administration.

In essence, the policy was nothing more than bringing to an end the persistent increase in circulation credit which the Democrats had fostered, or at least tolerated. Here was a new administration moving away from monetary malpractice and dishonesty. The consequences should *immediately* have been *salutary.*

But the actual *early* consequences appeared to be just the contrary. The steady business blood transfusions of new money in the form of circulation credit no longer being forthcoming, the "patient" began to feel distressed and ill. The "money market" (that is, the *loan money* market) tightened at once. All plans of business men had for long been basically adjusted to continuing monetary blood transfusions. The economic leaders were *accustomed* to count on more and more circulation credit. Those expec-

tations were deeply incorporated in all their plans. Now that expectation was not being fulfilled, and funds were not available to complete plans already "in the works"; and funds were still less available for initiating new programs which could only be executed on the assumption of a continued increase in circulation credit.

The New York Stock Exchange is the greatest *market* in the history of mankind. It is the meeting place of smart money and also of not-so-smart money. Astute buyers and sellers on the New York stock market immediately sensed the significance of the new financial policy of the Republican administration, and they discontinued buying and began selling, realizing that there would be deflationary consequences merely from no longer issuing additional circulation credit. By March the stock market was in full retreat. By April the alarm had spread widely to business. An anxious hue and cry began to come from the newspapers. There was fear of a severe depression with unemployment and distress.

Pressure on the very new admintsration to change its policy was steadily increased. By mid-May its fortitude was gone and it began to abandon its program. It has since that time never endeavored unfalteringly to reinstate it.

It was imprudent to adopt the policy of discontinuing the issuance of more circulation credit *without pre-advising everybody thoroughly about the immediate consequences which would be disturbing, and the long-term consequences which would be salutary.* If the administration had

(1) Explained its own policy, and the reason for it;
(2) Warned of the need of everybody rationally to adjust their own policies accordingly;
(3) Forecast, without evidence of anxiety, the disturbing *short-term effects;* and
(4) Assured, with confidence born of knowledge of economic law and moral law, that the *longer-term* consequences would be helpful to everybody, especially the "common man",

then public opinion would probably have supported the continuation of the new policy over the transition period long enough so that the eventual favorable results would have mustered public opinion solidly behind it. On all the foregoing counts, those who had an improved policy in mind failed to operate as *political* lead-

ers who know how to reassure their followers and retain their active support.

The initial program of the monetary leaders in the early days of the Eisenhower administration was not so definite nor inflexible as the program herein proposed. The financial policy in the early months of 1953 was the policy of a few men who "knew the score." It was not the policy of a whole party of well-informed citizens. It was not a policy which was proposed to be incorporated in statutory law, but merely a sound policy operated by a few individuals. To get a law passed making the policy the official and relatively permanent law of the land would have required a declaration of the policy, explanations of it, public discussion of it, and all the other requisites that go along with a sound government based on popular suffrage.

It is not possible for a few, well-informed men to set the monetary course of the United States soundly and keep it that way. They require the support of public opinion behind their program.

The program in 1953, although good as far as it went, was defective in being merely the program of experts unsupported by educational efforts and popular opinion, and deficient in not being incorporated in legislative law which would positively end the issuance of more circulation credit, as Peel's Bank Act ended the issuance of additional bank notes.

Nor is the evidence conclusive that the directors of the early Eisenhower administration financial program were *completely* convinced about *all* the objections to *additional* circulation credit. They may only have been opposed to the *too-rapid* issuance of additional circulation credit rather than the complete cessation of the issuance of additional circulation credit.

It is regrettable that the noble attempt in 1953 was abortive — because not clearly enough enunciated, not adequately justified to the public, not accomplishable because of a lack of supporting public opinion, and not definitely stabilized by being incorporated in statutory law.

Four Things Morally The Same - Circulation Credit, Fictitious Bills, Counterfeit Money, And Theft

Four different terms can be used for what, *in principle*, is the same thing:

1. Circulation credit
2. Fictitious bills
3. Counterfeit money
4. Theft

1. *Circulation credit* is the term selected by Mises. Mises hints that his term may not be ideal. As a term, it is weakest in the foregoing list. It definitely fails to indicate the moral turpitude of circulation credit. The term, theft, by its connotation, expresses an adverse moral judgment. Circulation credit, as a term, fails completely to indicate that there is theft involved.

2. A better term is *Fictitious bills.* This is the term that Henry Thornton accepted from popular usage to designate bills which merchants put out without the transaction being a response to a real transaction in commodities. (See Volume V, number 5, pages 144f. Further details on what Thornton writes about fictitious bills may be presented later. See page 87 in his book.) These fictitious bills were as much theft as circulation credit is theft. Whereas the term, *circulation credit,* does not warn a user that it refers to something evil, the word *fictitious* in Fictitious Bills performs that function fairly well, but not perfectly. *Fictitious* can mean that something is no worse than fancy or imagination; it does not necessarily mean that something is dishonest. What is needed is a vigorous term that unmistakably indicates moral turpitude.

3. *Counterfeit money* is a term that pretty much has a meaning which designates that moral turpitude is involved in putting it out and using it deliberately. *Counterfeit* is not a neutral nor a mild term. Still, it is vague in a sense in the minds of many people, because it does not indicate specifically in what the turpitude exists.

4. *Theft* is a wholly unequivocal term. Nearly everybody accepts it as being wrong. Circulation credit, fictitious bills and counterfeit money are all forms of theft. Circulation credit is legalized, and is by most people considered to be a source of prosperity, or a necessary prop to prosperity. Fictitious bills have been defended as a great aid in supplying the "necessary" funds with which to do business. Some of the most respectable people in the world have defended (or do defend) circulation credit and fictitious bills. But counterfeit money is generally condemned.

We shall use the four terms interchangeably whenever we refer to the *theft* which is accomplished by issuing circulation credit

in one form or another. A man is a thief when he thieves from others. He is also a thief if he accepts in exchange from others goods which represent real value, but gives in return something counterfeit in the sense that it does not represent his having performed a reciprocal act of providing real goods or services.

Maybe the best term to replace *circulation credit* would be *counterfeit credit. Circulation credit* is to *commodity credit* what counterfeit money is to real money. It appears justified to use the term *counterfeit credit* in place of *circulation credit.*

Morally, there is no difference between circulation credit (which is installed in the monetary and banking structure of the United States as if it were honorable and desirable) and counterfeit bills or coins. Because circulation credit is not *open and obvious* theft, because of the lack of understanding of it by most people, and because they do not openly resist it, its consequences are indirect, and its penalties are not understood. Its penalties, by the way, show up in the form of booms and depressions, and not in jail sentences.

In the elementary and fundamental categories of the Decalogue of Moses, circulation credit and fictitious bills and counterfeit money are all forms of theft, and are forbidden.

★ ★ ★

"Of all the contrivances for cheating the laboring classes of mankind, none has been more effective than that which deludes them with paper money."

—Daniel Webster

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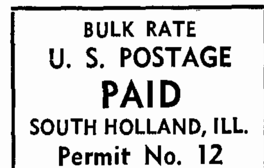

POSTMASTER:
FORM 3547 REQUESTED