THE LOST ART OF COMMERCIAL BANKING

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ECONOMIC EDUCATION BULLETIN

AMERICAN INSTITUTE for ECONOMIC RESEARCH

Vol. XIV No. 6

ECONOMIC EDUCATION BULLETIN

June 1974

Published by

AMERICAN INSTITUTE for ECONOMIC RESEARCH

Great Barrington, Massachusetts 01230

The Lost Art of Commercial Banking

The evolutionary development of human culture extended over millions of years. The written record of what has occurred is relatively short, but we know not only from the written record but also from the artifacts of earlier human societies that men acquired various arts or special skills only to lose them in subsequent centuries.

Perhaps in most instances loss of acquired arts was not a determining influence in the retrogressions, the decline and fall of an unknown number of civilizations. However, in the present century an art has been lost or nearly lost, and the consequences may have a significant influence on the breakdown of Western civilization. This now nearly lost art is the art of commercial banking.

As has been true for many developments in human culture, commercial banking evolved as men attempted to cope with their problems, in particular the exchange problems encountered in a world of rapidly increasing production, one result of the industrial revolution. From one point of view, the development of modern science and its technological application to production, forced the more or less parallel development of commercial banking. Although more and more men learned the procedures of scientific inquiry that enabled them to create the amazingly productive modern industrial society, they never did apply similarly scientific methods of inquiry to the problem of effecting the tremendously augmented number of exchanges that characterized mass production for mass markets. Commercial banking evolved as an art by a succession of trials and errors just as many other human arts have developed rather than as an outcome of scientific inquiry.

Eventually the developing art of commercial banking was crudely described and in some degree understood by its practitioners. For about a hundred years it was sustained at an advanced level of development before retrogression began. More will be reported subsequently about aspects of the retrogression; at this point we simply mention that almost no bankers and few money-credit economists today are familiar with significant aspects of this lost art. Even the most ardent advocates of sound money, of the gold standard, of a useful accounting unit seem not to realize that until the lost art of commercial banking is revived and generally applied there can be no hope for the money-credit system of Western civilization.

Throughout the civilized world, inflating has become the great destroyer. The signs of pervasive economic distortions leading to social disorder and retrogression are clearly evident. Some economists seem to believe that restoration of the gold standard or some other panacea could remedy the situation. However, a return to the gold standard or any other attempt to stabilize money-credit systems would be short-lived and self-defeating without application of the lost art of commercial banking.

No doubt, other lost arts that once flourished seemed durable and assured of perpetuity by those who practised them. But the fact is that arts once lost have not readily been recovered, even when to the earlier practitioners the arts had seemed so easily understood, so readily discoverable, that little trouble was taken to perpetuate them.

In attempting to describe the lost art of commercial banking we have at least two ways of proceeding. One would be to explore the evolutionary development, describe the failures and the successes, and thus finally exhibit the art as practised for nearly a century. A second way of proceeding would be to describe what objective was achieved by sound commercial banking and list in detail various aspects of the useful procedures. For the purpose of this article, the second way of proceeding has been chosen.

The Problem That Was Solved by Commercial Banking

Medieval markets were like those existing today in the more primitive societies. Things were produced on a small scale, were brought to the public markets by the producers or their families or friends, and exchanges were effected by barter in large part. Even in those early markets where money was used, the money frequently was gold or silver coin, and the transactions more nearly resembled primitive barter than the modern banking and exchange procedures now widely used.

However, as the industrial revolution developed through the eighteenth and nineteenth centuries, mass production for mass markets became commonplace. The flow of things to organized and continuous markets became thousands of times the physical volume of things exchanged earlier. Today, as anyone who has observed modern shopping centers, supermarkets, major discount houses, and department stores can see for himself, the problem of facilitating exchanges has become enormous compared with the exchange problems of a village market centuries ago.

Today's problem may be summarized as follows:

a. Coming to the markets of any country such as the United States is a vast flow of merchandise, transported in ships, freight cars, trucks, and airplanes, a flow continuously in movement day and night (with intermissions for parts of the flow at times).

b. Millions of individuals and businesses obtain varying portions of this flow, for consumption or perhaps for facilitating the production of other things.

c. Clearly, one basic problem that must be solved, if the flow is to continue uninterrupted and without either accumulations of surpluses or serious scarcities in the markets, is to provide for potential claimants or buyers the claim checks or purchasing media that will enable them continuously to buy what is offered. Enough, but neither an excess nor a deficiency of claim checks, must be provided.

If you were suddenly confronted with such a problem, and had no experience with modern financial and exchange procedures, had never handled what you think of as money, the problem might well seem extraordinarily difficult. Remember that innumerable items flow into the markets: gold ingots from South Africa, manufactured watches, silver in many shapes and forms, diamonds and other precious gems, food in infinite variety from raw material to precooked TV dinners, fabrics and clothing also of seemingly unlimited variety, millions of automobiles, all kinds of chemicals, medicines, household appliances, etc.

Also, remember that practically all of the buyers in the markets have, in some manner or another, participated in the processing efforts that have resulted in this vast flow of things. Each is entitled to his share: this man has fitted the wheels on each of thousands of cars; that woman has sewn the seams of hundreds of suits; this manager has coordinated the efforts of a few hundred thousand people engaged in processing a flow of tires to market; another man has loaned his savings to a company that provides electricity for all to use; still another, a barber, has just performed a service for Tom Jones and has received from him some of the claim checks earned by Tom during the past week, so that, although a barber sends no things to market, he also obtains the means to buy.

Let us suppose that your problem is to provide for all the potential sharers in the flow of things some means of claiming their shares in the markets. We shall not suggest that you stumble down all the blind alleys where men were frustrated in trying to solve this problem during the long evolutionary development of useful commercial banking. Instead we provide a summary description of the most advanced, most efficient stage of development that was reached in the decades before World War I.

We chose that stage of development because retrogression began with World War I as will be described in more detail later.

How a Useful Money-Credit System Functioned

One of the obvious requirements for solving the problem as described is an accounting unit in terms of which the exchange values of all things in the markets can be determined. Clearly, claim checks valid in the markets for purchasing things being offered for sale must be denominated in some unit of measure for exchange values. Thus, the claim checks can be anonymous and available for general use in claiming (buying) any thing. Unlike the situation in a baggage check room, those who wish to claim things offered in the markets want their claim checks to be valid for any item available, rather than valid for claiming only one thing. The buyer in a market wishes to claim the number of units of exchange value to which he is entitled rather than the specific items that he may have participated in producing or in bringing to the market.

Nevertheless, the market situation is in some respects like that in a baggage checkroom. If claim checks for baggage were counterfeited, or in some way were issued when baggage had not actually been left in the checkroom, people could be trying to claim more baggage than there was baggage to claim. Conversely, if baggage checks that had been issued properly as baggage was received were either lost or destroyed, some baggage eventually would remain unclaimed in the checkroom.

Similarly in a nation's markets, if the claim checks (or purchasing media, or "money") were counterfeited or in some other ways amounts were issued to potential buyers in excess of the amounts required to represent values of things in the markets, buyers would have far more to spend than the usual market prices of things for sale. In trying to use their excessive purchasing media, buyers would bid for relatively scarce goods, and prices would rise.

In the reverse situation, that is, if claim checks (purchasing media) were not issued in sufficient amount to represent the values of things being offered in the markets at the usual prices, prospective buyers would not be able to claim all the things offered. Then merchants would be forced to reduce prices in order to sell their stocks of things before the continuing flow of goods to market exceeded the capacity of their storerooms.

The accounting unit finally chosen by all leading industrial nations was a specified amount of gold by weight and degree of purity. In some instances, different weights of gold were designated as the accounting unit, and various names were applied by the different nations to the weights of gold they selected, such as dollars, francs, pounds, etc. Nevertheless, because all the accounting units were gold all were freely exchangeable with one another in the simple proportions of their relative weights of gold.

While these conditions prevailed, any specific number of the accounting units designated so much gold by weight. One had no need to talk about a "price" of gold in terms of the various currencies, any more than one would discuss the "price" of a bushel of potatoes in terms of potatoes. One might talk about the weight of a bushel of potatoes as being 60 pounds of potatoes; and in similar fashion one might talk about 100 dollars as being a specified amount of gold by weight, because a dollar by statutory definition was approximately one-twentieth of an ounce of gold in an alloy nine-tenths fine.

The fact that gold was the accounting unit chosen explains neither how that choice came to be made nor how it facilitated the issue of claims for things in the markets. As for how the choice happened to be made, we shall comment here only briefly.

As human culture evolved, men discovered the usefulness of gold as an exchange medium. This was not a scientific discovery in the usual sense involving laboratory experiments and analyses; it simply was the result of unplanned experience. Men discovered the durability of gold, which neither rots nor rusts; its comparative scarcity; the fact that its exchange value for other things (or rather for the average of other things over wide areas and prolonged times) was relatively stable, as compared with the relative exchange value of anything else; even its pleasing appearance to men and women; its easy divisibility; and possibly other attributes may have been taken into consideration.

At this point we are focussing attention on some of the facts and are not attempting to describe how those facts came to exist. These are aspects of the entire problem that need not concern us here, however, interesting they may be to students of economic history. The fact is that gold was the unit of account for modern industrial civilization.

We turn now to a description of the commercial

banking procedure that issued claim checks representing things in the markets, retired those claim checks from circulation as things in the markets were sold, and issued new claim checks to represent the new things coming into the markets. These procedures had to occur in order to facilitate the huge volume of exchanges essential to the orderly functioning of a modern industrial society.

At this point, one must first realize that gold held in the banking system was one of the things continually offered in a nation's markets. As gold was brought to the banks, paper currency was issued to represent it, or additions to individual checking accounts were made to represent the gold; i.e., to the account of the man who deposited gold was added, by a bookkeeping entry, the appropriate number of gold accounting units (in the United States, dollars). These purchasing media, i.e., currency or checking accounts, could be used by the holders at any time to claim gold from the banks, that is, to buy the gold in that segment of the nation's markets.

The commercial banks also created claim checks (purchasing media consisting of currency and checking accounts or demand deposits) representing things being shipped to and offered in the nation's markets. The procedure formerly more widely used is somewhat easier to understand.

As a manufacturer shipped completed things to market, he would prepare a document describing the shipment, take it to his bank, and borrow purchasing media that, in practical effect, represented the things en route to market. The bank made the loan by crediting an appropriate amount to the checking account of the manufacturer, but this amount was *not* deducted from other checking account liabilities of the bank. Thus, new purchasing media were created and were placed in circulation when the manufacturer used the addition to his checking account to pay wages, salaries, suppliers, and other costs of processing the things sent to market. (As the things were sold, the receipts from sales were used to repay the bank loan by having the amount deducted from the manufacturer's account. Thus the purchasing media created for temporary use were withdrawn when their purpose had been served.)

Those who received the newly issued purchasing media from the manufacturer then could choose whatever they wanted that the markets offered. Also demanding things in the markets were those individuals who had purchasing media representing gold in the banks. Everyone who had purchasing media at his disposal could buy anything he chose in the markets including the gold continually being offered by the banks as one segment of the entire market.

At all times some individuals and some businesses desire to retain all or part of their available purchasing media for near-future use. Tom Jones, for example, prefers not to buy ordinary merchandise today but plans to buy tomorrow or next week. Therefore, he claims gold at the bank intending to hold it until later when he can use it directly to buy other merchandise; or he may redeposit it and use the currency or checking account that he thus obtains to buy later in other segments of the market. Also, he may simply hoard currency or leave his checking account inactive while Dick Smith who has an equal amount of purchasing media representing gold uses his currency or checking account to buy merchandise today. The result is the same as though Tom Jones had said to Dick Smith, "Let me have your purchasing media representing gold in exchange for my purchasing media representing other merchandise, so that you can buy general merchandise other than gold today and I can wait until tomorrow (or next week)." However, because all the purchasing media used is free of any tie to a particular product, such a conversation is unnecessary. The result is obtained without any need for Tom Jones to find and agree with Dick Smith.

A brief digression is necessary at this point, because the procedure described above has been modified in recent decades as mass production has developed on a broader scale and now occurs almost continuously throughout the year. For example, automobile manufacturers ship cars to market practically every business day except for the few weeks each summer when plants are closed for the changeover to new models. Preparing new sets of documents nearly every day for all shipments for use as a basis for bank credits would be unnecessarily time consuming. Consequently, a different procedure has been developed.

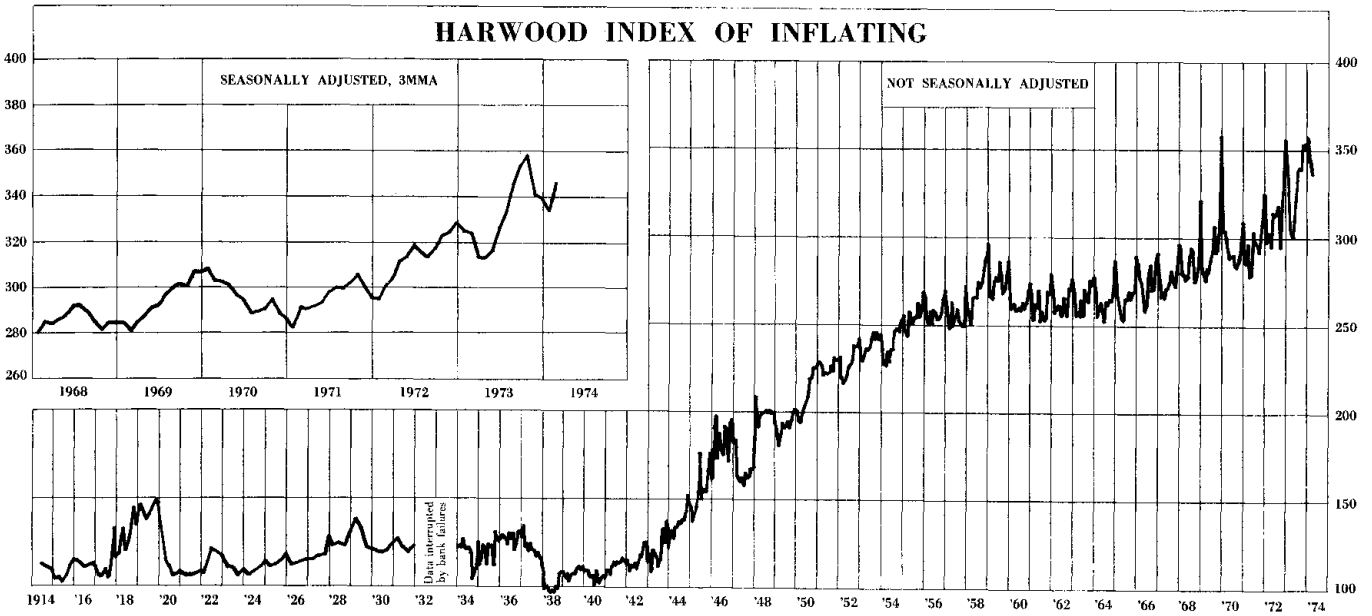
The automobile manufacturer arranges with commercial banks for a "line of credit" and gives a promissory note that may be paid off only once each year during the model changeover period when no cars are en route to markets. Thus a series of borrowings continually being repaid as cars are sold is replaced by a single borrowing resulting in the creation of purchasing media that remain in circulation as long as the flow of cars to markets continues. Instead of using the receipts from today's sales of cars to pay off the note secured by the bill of lading for the shipment, the receipts from today's sales are used by the manufacturer to finance his next shipment. (Whether the time intervals involved are daily, weekly, or monthly depends in part on customary timing for the payment of wages, salaries, dividends, bills for materials, etc.)

Clearly, the art of commercial banking requires knowledge about many aspects of production and exchange. The banker must be an expert judge of financial statements and must know the customary production and shipping procedures of those for whom he creates new purchasing media by discounting their notes. He also needs to have some knowledge of market prices, although much of this information is available in the records of billings by the processors of things being sent to or in the markets.

The commercial banker must have some basis for judging prices. Inasmuch as gold by weight is the accounting unit, when the gold standard is in general use as it was before World War I, prices of all things except gold are quoted in terms of gold. For example, at that time, "dollar" was simply another and shorter name for about one-twentieth of an ounce of pure gold in an alloy nine-tenths fine. (Probably human beings are the only form of life on earth that can be persuaded to believe that a name such as "dollar," after having been irrevocably severed from reality so that no longer is it a name for any tangible thing, nevertheless can be used as though it still named something in the real world.)

Potential Errors in Judgment

From the summary description given above, one can realize that possible errors by commercial bankers in judging the prices of things that are represented by new credits, by newly created purchasing media, could have disturbing repercussions. If, because of overoptimism about prices generally, the bankers created so much new purchasing media that prices in the United States increased in relation to prices for similar things elsewhere in the world, some potential buyers would buy in foreign markets. In that event, the banks would have had to send



The actual developments that have led to the present situation are reflected in the charts on these two pages, which illustrate not some theoretical or imagined relationships but the actual course of money-credit events during recent decades.

The chart above shows the ratio of total purchasing media to the portion that is noninflationary (that is, represents gold or other things being offered in the markets). Clearly, the increasing creation of inflationary purchasing media in recent decades has resulted in an even greater departure from sound commercial banking than that of 1929.

The purchasing media available to the public in the United States include all coins, the paper currency (consisting largely of Federal Reserve notes but including Treasury currency), and checking accounts (or, as the banks label them, demand deposits). All purchasing media in use, or that someone holds available for use, have come from one of the sources described in the paragraphs that follow. The purchasing media derived from these sources are represented by the areas on the other chart. The sources are described in ascending order of these areas.

The first and an important source of purchasing media is the thing chosen as the basic or standard purchasing medium. In the present industrial civilization, the money commodity is gold.

In spite of the so-called departure from the gold standard, gold is still the money commodity of modern civilization. Existing gold held as reserves of the various banking systems actually is being used as purchasing media, although it circulates in an altogether different form than the gold coins or gold certificates that formerly were available.

When the Treasury acquires gold, the seller receives a check drawn on the Treasury's account; and the Treasury ordinarily counter-balances these drafts against its checking account by depositing certificates representing the gold with the Federal Reserve banks.

By this means purchasing media equivalent in value to the gold sold to the Treasury are made available to the seller; and, when he uses the funds to buy some things desired, the purchasing media pass on to someone else and thus remain in circulation.

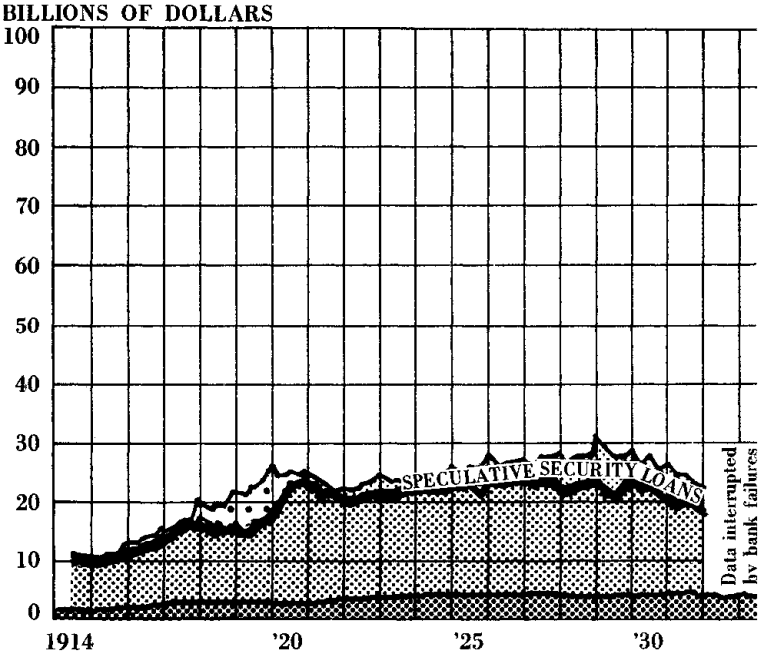
A second source of purchasing media is the commercial lending function of a commercial banking system. The borrower whose note is discounted receives a bookkeeping credit to his checking account that is not previously deducted from someone else's account. This action places at his disposal new purchasing media (in addition to those previously existing) that represent things that the borrower offers in the markets. Therefore, such purchasing media are not inflationary.

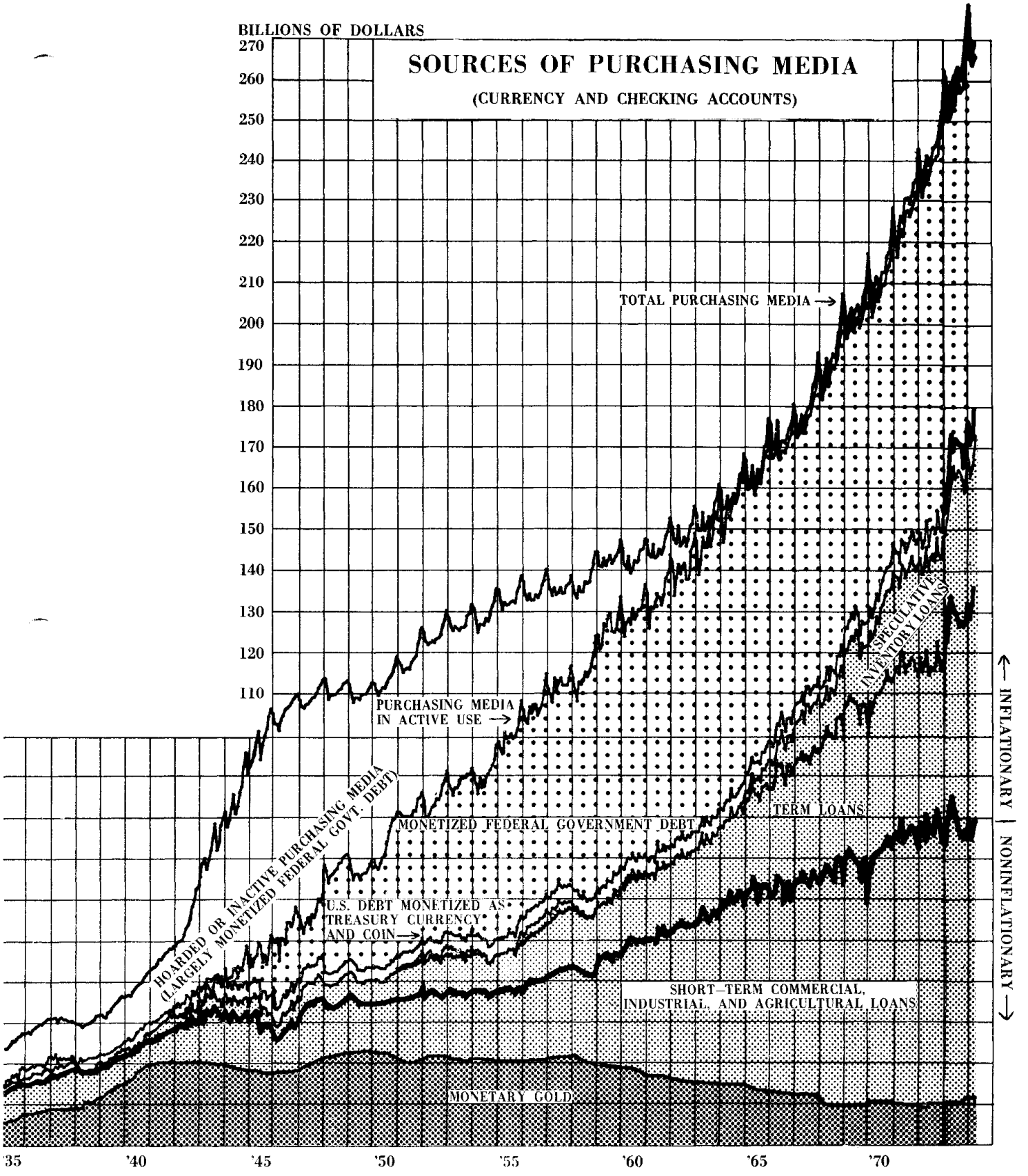
The third and fourth sources of purchasing media are also the commercial banking system and also involve a bookkeeping credit to the borrower's checking account as in the commercial lending mentioned above. However, purchasing media derived from these sources do *not* represent things that the borrower offers in the markets. The loans involved thus are investment-type assets of the commercial banks. (The amounts of speculative inventory loans are estimates subject to revisions.)

The fifth source of purchasing media is the currency issued by the Treasury in the form of United States notes, Treasury notes of 1890, Federal Reserve banknotes, national banknotes, dollars, subsidiary coin, and minor coin. Because this kind of currency is created by the direct action of the Treasury and does not reflect either an increase of gold or in other things coming to market, the Treasury currency is classified as inflationary purchasing media.

The sixth source of purchasing media is the commercial banking system's investment in Federal Government obligations to the extent that such investments exceed the capital and savings accounts of commercial banks that are available for that purpose. We refer to this source as "monetized Government debt," because the commercial banks create *new* purchasing media in exchange for these Federal debt obligations.

The significant development reflected in the chart, which largely accounts for the present domestic money-credit chaos and the virtual international bankruptcy confronting the United States, is the prolonged and marked inflating that has occurred during the past three decades. This development is reflected in the huge amount of inflationary purchasing media shown in the upper areas of the chart.




BILLIONS OF DOLLARS
SOURCES OF PURCHASING MEDIA
(CURRENCY AND CHECKING ACCOUNTS)
270
260
250
240
230
220
210
200
190
180
170
160
150
140
130
120
110
TOTAL PURCHASING MEDIA →
PURCHASING MEDIA IN ACTIVE USE →
HOARDED OR INACTIVE PURCHASING MEDIA (LARGELY MONETIZED FEDERAL GOVT. DEBT)
MONETIZED FEDERAL GOVERNMENT DEBT
U.S. DEBT MONETIZED AS TREASURY CURRENCY AND COIN →
TERM LOANS
SPECULATIVE INVENTORY LOANS
SHORT-TERM COMMERCIAL, INDUSTRIAL, AND AGRICULTURAL LOANS
MONETARY GOLD
← INFLATIONARY | NONINFLATIONARY →
'35
'40
'45
'50
'55
'60
'65
'70

gold abroad, because a foreign holder of U.S. purchasing media (or of claims on it) would buy the relatively cheapest thing available in U.S. markets, which would at that time be gold.

The outflow of gold would reduce the purchasing media in the United States representing gold and thus would reduce somewhat demand for other things. Prices of most things would fall and the commercial bankers' error attributable to overoptimism perforce would be corrected. A cumulative distortion attributable to errors of overoptimism would seem to be highly improbable provided the basic principle of sound commercial banking were followed.

However, other major errors of a different type have occurred, of such nature as to create increasingly greater distortions leading to periodic breakdowns of the money-credit system. How these errors occurred will now be described.

Savings and Investment

As commercial banking has developed, especially in the United States, two quite different functions have performed by the same institutions. In addition to commercial banking as already described, most banks also accept savings to be invested.

Savings are purchasing media that the original holder decides not to spend himself but instead requests the bank to invest for him and pay him interest on his savings account, sometimes called a time deposit. The bank invests such purchasing media by lending it to a borrower who perhaps is buying equipment for his factory or to a borrower who may desire to buy a new car or for some other purchase. Thus, the purchasing media (currency or checking account) are used by someone to buy things in the markets although the original recipient of those purchasing media chose not to buy but to save. He acquires a credit to his savings account or time deposit, which shows that he is the owner, indirectly, of whatever investments the bank has selected, such as bonds, mortgages, installment loans, etc.

The borrower from the bank in the savings-investment transaction is *not* at that time sending to or otherwise offering things of equal value in the markets to be sold. He does *not* desire purchasing media so that he may distribute it to employees and suppliers who participated in preparing things *for* the markets. His desire is to claim things *from* the markets, either equipment for his factory, or a new car for personal use, or any of the multitudes of other things available, such as new bricks for construction of a factory, etc. Consequently, the bank should not create new purchasing media for such a borrower but should lend him purchasing media already in existence that some present owner or owners save and deposit in the bank.

Probably because the same banks have been performing two functions, each of which involves lender-borrower transactions and similar, often identical forms (such as promissory notes) and related procedures, many bankers have confused the two functions. Extreme examples were numerous in the late 1700's and early 1800's.

In the United States the so-called "wildcat banks," usually small institutions in more or less remote areas, so inextricably confused their two primary functions that they not only created new deposits (by discounting notes and crediting the proceeds to checking accounts) for typical commercial purposes but also they followed the same procedure and created new checking accounts when discounting mortgage notes. In the first type of procedure, the new purchasing media created represented the exchange value of things en route to or being offered for sale in the local markets, but in the second the new purchasing media represented things (such as land, factories, or consumer goods not being offered by the borrowers for sale but on the contrary being removed by them from the markets).

Perhaps the most easily confused examples of commercial vs. noncommercial banking are provided by the financing of automobiles in or en route to markets in contrast with consumer installment borrowing to purchase a new car. The important distinction that makes all the difference between sound and unsound commercial banking is:

a. When an automobile manufacturer borrows newly created purchasing media and distributes them among employees, suppliers, and others, he is arranging for those potential buyers to obtain their shares in dollar value, of things in or en route to markets.

b. When an installment buyer arranges to purchase a car, he is *not* claiming a share corresponding to his participation in producing things for markets, he is claiming someone else's share. James Brown can properly do that provided John Doe is willing to lend to James Brown the share that Doe's purchasing media (currency or checking account) proves he is entitled to claim. Such an arrangement usually is effected via the savings-investment procedures with a bank as intermediary. If the bank creates new purchasing media for James Brown to use instead of arranging a loan from John Doe or others, the result will be more purchasing media available to potential buyers than the corresponding value of things in or en route to markets.

c. Thus, one can see that a bank's lending transaction may reflect additional things offered in the markets *or it may not.* If it does, creation of new purchasing media (for use until retired by repayment of the loan by the seller) is sound commercial banking. If the lending transaction does *not* reflect *additional* offerings in the markets, it should be financed by the savings-investment procedures.

When the borrowers from "wildcat banks" attempted to buy, they discovered that merchandise was scarce; they bid prices higher and higher for the available things. Soon, those having purchasing media tried to buy more cheaply in foreign or at least more distant markets. The sellers in those markets did not wish to buy most things in the local markets but used their claims to demand gold from the "wilcat banks," which then were unable to meet their obligations and collapsed.

This disastrous syndrome has been repeated again and again in human experience. Another notorious instance was that of the Scottish banks, of which a multitude collapsed after similarly neglecting to apply what might be called the basic principle of sound commercial banking.

Finally, the lesson was learned. For nearly a century prior to World War I, the leading English banks applied the basic principle of sound commercial banking most of the time with outstanding success. The basic principal became more widely understood and applied among industrial nations. Even the United States, which had been one of the "slow learners," did embody this basic principle in the legislation that initiated the Federal Reserve System in 1913. The Federal Reserve banks originally were permitted to rediscount for the member banks only commercial paper directly tied to the volume and value of things flowing to markets. Such widespread application of the basic principle of sound commercial

banking marked the farthest advance achieved by the human race in the evolutionary development of a money-credit system that could serve a modern industrial society.

During World War I the prolonged evolutionary development ended, and retrogression began that has continued to date. Perhaps the decisive influence was the political decision by each leading combatant to finance the war by inflating. This procedure was not justifiable on economic grounds (as Napoleon had demonstrated a century earlier), but apparently it was politically expedient. The basic principle of sound commercial banking was simply disregarded when the governments used the various banking systems as means of monetizing government debt. Not only the central banks but also the commercial banks generally were stuffed with government paper (promissory notes of short and long duration, the latter called bonds), in exchange for credits to the checking accounts of governments. What happened then and since is summarized below.

Developments During Recent Decades

In the last part of the 1800's and until World War I (1914), all of the leading industrial nations of the world and many others used a common international monetary base. All of their currency units were gold, although some used different weights of gold than others did, and various names were used for the different unit weights, such as "dollar," "pound," "franc," "mark," etc.

Because each currency unit was gold, each was readily exchangeable into any other, based on the relative gold contents of the unit. In practical effect, troy ounces of gold, or in the metric system grams of gold, were the international unit for all currencies of leading nations.

This situation, which included the advanced stage of commercial banking already described, represented the peak of development for Western civilization in monetary matters. It facilitated commerce and made possible long-term accounting records that were meaningful rather than fictitious. Not only commerce between nations but also the great increase of useful capital was encouraged by the growth of savings instututions, life insurance, and pension funds.

During World War I, the nations concerned inflated by printing paper money and monetizing government debt unrestrained or not limited by any relation to the gold currency unit. The results were catastrophic:

a. In Germany, the money became worthless in 1923, with complete loss of savings, life insurance, pensions, and an economic breakdown with serious depression. A new gold monetary unit was adopted. In some other countries the experience was similar.

b. In France, the loss of buying power of the currency was not so extreme as in Germany; but the French franc, by the time De Gaulle became president in 1958, would buy less than one two-hundredth of what it bought in 1914.

c. In Great Britain the pound sterling lost much of its buying power, but an effort was made in 1925 to restore the prewar gold currency unit.

d. In the United States the consequences were less serious, although a noticeable loss in the buying power of the dollar occurred.

Between World War I and World War II, an effort was made to restore the pre-World War I monetary situation. However, the procedure adopted facilitated inflating again as some currencies, especially the dollar and the pound, were widely used as reserves in other countries as though they were gold. The basic principle of sound commercial banking was disregarded; and the inflationary boom of the 1920's was the immediate result followed by the Great Depression of the 1930's.

During World War II, the inflating procedures used during World War I again were applied, with similarly disastrous consequences for many nations.

After World War II the leading nations joined in establishing a new international monetary system based on gold. However, once again they repeated the mistake of the 1920's by providing that the currencies of some nations could be held instead of gold as the reserves of other nations. In practical effect, this meant counting gold twice, once where it actually was held and again in some other countries whose central banks held claims on dollars, pounds, etc.

In the decades after World War I, the basic principle of sound commercial banking was so far departed from that it was largely forgotten. Also, during the 1930's, the years of the Great Depression, the economic notions of John Maynard Keynes became widely accepted as the remedy for depression difficulties. The "new" economic ideas (actually very old, but new to many ignorant of history) became virtually a new economic "religion" with fanatic followers in all the leading universities of Western civilization.

To summarize, the new ideas involved perpetual inflating as a means of achieving perpetual prosperity. Dr. Keynes' ideas were embodied in the charter of the International Monetary Fund, created in 1945-46. As was intended, it became a great engine of inflation, and thus functioned for nearly three decades.

The Situation Now Existing

The results of forgetting the art of sound commercial banking, of accepting almost universally the Keynesian secular revelations, and of adopting perpetual inflating as not-to-be-questioned government policy are becoming increasingly apparent and increasingly unpleasant. That the economic distortions created are disrupting social order hardly will be questioned by anyone who has even a glimmer of understanding of the news behind the news. Andrew Dickson White reported on inflation in France in the late 1700's, commenting that all the worst characteristics found in human nature, avaricious embezzling, reckless speculation, betrayal of trust, and the like, grew like "fungus on a muck heap." When one observes what has gone on in high corporate finance, in banking, in government during recent years, one is impressed with the extreme fertility of the Western civilization "dung heap." Most prominent today are not the characteristics of a lasting social order; at least one hopes that these characteristics will not last. Unfortunately, however, present indications are that developments will be worse, much worse, before there is a lasting turn for the better.

Consider, for example, the 1973 meeting of the International Monetary Fund in Nairobi. Several hundred of the world's leading bankers, government financial personnel, and economists solemnly met for a few days. With straight faces they discussed Special Drawing Rights, the so-called "paper gold." Not a man stood on his feet and declared, "Gentlemen, we are laboring under the delusion that imposing names must apply to something, but there is no reality to which the name 'paper gold' can be applied. The fruitless efforts of our Group of Twenty should be enough to convince anyone. We are not so much making fools of ourselves as exhibiting the fact that we are an aggregation of monetary novices. Those of us in banking are mere pawnbrokers in marble halls, most of whom never learned the art of commercial banking or even know that there once was such an art. With the aid of ignorance, cupidity, and expediency on the part of our friends in governments, we are destroying a civilization. Let us stop and try to learn from the lessons of the past."

Now the point of this imagined comment is not to castigate the world's bankers and politicians, however well they may merit such castigation. The point is that no single man in banking or in government and no group of men is urging the desirability of leaving the world of dreams and returning to reality. The inescapable conclusion is that there is little or no reason to hope that inflating and the resulting destruction of social order will be stopped short of terrible disaster.

Even the advocates of a return to the gold standard do not provide good reason to hope that a turn for the better can be achieved. Almost none of them understands that application of the basic principle of sound commercial banking is essential to make the gold standard, or for that matter any other monetary standard, useful in the long run.

Among the gold standard advocates are found the 100-percent-reserve proponents who would restrict the purchasing media in use to gold and perhaps silver coins or paper currency and to checking accounts directly representing these. They would go back to medieval times before the earliest beginnings of sound commercial banking. How they would cope with the flood of products to be marketed in a modern industrial civilization they do not suggest, nor do they seem to realize that a problem might exist.

Others among the gold-standard advocates offer a simplistic solution, raising the "price" of gold and restoring convertibility of currencies to gold. They seem not to realize that a huge volume of inflationary purchasing media exists and is polluting the money supplies of the world just as would multiple billions of counterfeit currency. Few add to this simplistic solution a proposal for removing excess purchasing media from circulation (deflating) and thereafter prudently applying the basic principle of sound commercial banking.

An art that mankind once acquired has been lost. This assertion does not imply that the art in question had been developed to perfection. Wise men do not hope to achieve perfection; they aim at solutions that work passably well in the real world and try to improve upon them, more nearly to perfect the application of basic principles discovered, and to preserve the best of what already has been achieved while striving to achieve even better results. Until the art of commercial banking becomes a science, and like most of man's studies of human behavior that is a long way in the future, can we do better than revive the lost, but not entirely forgotten, procedures that once worked so relatively well, in contrast with the international monetary muddle we have today?

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