

## Chapter 17

# On the Acid Test: Deflation

My interest in money as a problem began during the Great Depression forty years ago. The problem then was not inflation but deflation; not rising prices but declining prices. When I was lecturing about the situation in Bloomington, Illinois, at Illinois Wesleyan University, corn which had gone up to \$2.00 a bushel during the post war boom, was selling in that center of the Great American Corn Belt a 20 cents a bushel. Everything in America, from the stocks and bonds which had been unloaded on the public during the New Era of Perpetual Prosperity in the 1920's, to the land which farmers had gone into debt to buy during the war, was selling at similarly low prices. Not only were the investors and the farmers bankrupt—so were the banks which had financed them.

The problem then was not a superfluity of dollars, as is the case today; it was an insufficiency of dollars. Everybody was hoarding the dollars they might have managed to save from the holocaust; nobody could borrow dollars for love nor money.

The acid test of my experiment with the constant and of my proposal for a bank to issue a stable currency is: What

would have happened if the experiment had been tried during the Great Depression? What would have happened if the problem to be solved had been deflation and not inflation as is the case today? To answer that question in detail would take another book just as large as this one. But no such book is needed. All that is needed is a statement of the principles and policies which should govern the operations of BISC in such a contingency.

Fortunately, the answer to that will only take a few pages.

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Suppose that by some miracle the country, instead of finding itself still in this period of nearly full employment, were to find itself in a period when nearly a third of the labor force was unemployed? Suppose the headlines in the newspaper dealt with deflation instead of inflation? Suppose that the Federal System had been and was still continuing to reduce the money supply instead of increasing it, as it has been ever since the IMF was organized? Suppose that reserve requirements for all the banks of the country had been increased so as to reduce the total money supply still further? Suppose that the country was confronted not with easy money but with the fact that it was almost impossible to borrow any money from any bank for any purpose however legitimate? What would happen?

Prices on everything would drop precipitously, the cost of living index and wholesale price index instead of rising as they are now would be dropping each month. Corn prices would drop, gold prices would drop, stock prices would drop, land prices would drop. Demand for everything and sales of everything would drop. Factories would shut down, stores would go out of business, farmers would get almost nothing for their crops. Bankruptcies would become epidemic as they became epidemic during the Great Depression. Unemployment would shoot up; it would increase not

to five or six percent as it has during the depressions since Keynesianism took over, it would increase until one-third of the labor force was unemployed as it was after the stock market collapsed in 1929.

What would BISC be able in such a contingency to do? Would the principles by which it should be guided as they have so far been described apply? Would they make it possible for BISC to cope with deflation as the Exeter experiment indicated it would be able to cope with inflation? Would a stable monetary unit such as the constant be driven out of circulation by the fact that the dollar, instead of losing purchasing power, was all the time becoming more and more valuable?

What would be the principles and what would be the policies which would guide the officers and the trustees in dealing with such a deflation-produced depression as I have tried to visualize?

Very briefly, the principles which would guide them would be exactly the same.

Their policies, like the principles upon which they are based, would also be the same. BISC would continue to do business as usual, continue to accept deposits as usual, to make loans as usual, to maintain the commodity reserve as usual, and to make redemptions as usual.

What now would happen if BISC dealt with a deflationary depression in exactly the same way in which it dealt with an inflationary explosion?

Deflationary depressions, different as are their histories, are all alike in one respect. The Great Depression, like all deflationary depressions, was caused by just one thing, a drastic reduction in the money supply. Dollars virtually disappeared. The banks stopped making loans for any purpose. Most of them couldn't have made them even if they had wanted to—they were insolvent. During the 1920's they had been financing the speculative orgy called the New Era; they had loaned billions of dollars on the security of stocks and bonds; suddenly they found themselves loaded down

with defaulted securities—securities which were worthless or salable only for a few per cent of what they had loaned on them. To top it all, the Federal Reserve System refused to issue the dollars which it should have been able to issue if it too had not helped finance the banks in financing the New Era. Finally, those who had managed to hang on to their dollars in spite of the debacle, hoarded them and refused to use them.

With BISC in existence and with a complete alternative currency available based upon constants, not dollars; with BISC doing business as usual, making loans and discounts as usual, and issuing and redeeming constants as usual, people would very quickly have discovered that an alternative to the dollar was available. They would have discovered that they could do with constants what the deflation of the dollar supply had made it impossible to do with dollars. They would have started doing business in constants. Farmers would have sold their crops for constants; manufacturers would have paid for their raw materials with constants; salaries and wages would have been paid with constants, stores would have sold the consumers what they wanted for constants. Legitimate borrowers would have found that they could borrow what they needed in constants and that productive undertakings of any kind could be financed with constants.

That's what would have happened.

And that's what did happen in one small city in Germany during the Great Depression when a viable alternative currency to the mark was made available to the people and the businessmen in that city.

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During the 1930's someone handed me a copy of a pamphlet called "The Miracle of Woergel". Woergel was a very small city in Germany which by some miracle was

doing business as usual when nobody in the rest of Germany was doing anything as usual at all. The pamphlet introduced me to the ideas and to the writings of Silvio Gesell.

Our economic amnesiacs, if they ever heard of Gesell and his idea of a demurrage currency, have forgotten all about him and all about the fact that in spite of the Great Depression, at least in Woergel, his idea had worked. His idea was the issuance of a currency on which a demurrage charge was made each month. A stamp had to be purchased and affixed to each note monthly. Notes which were without all the stamps needed were accepted only at a discount. The notes in effect lost purchasing power each month. Naturally everybody spent them as fast as they could, particularly toward the end of each month when the stamps had to be affixed. The income from the stamps paid for the operation of the organization which issued the notes. Nobody, Gesell maintained, would hoard this kind of currency as they were hoarding the ordinary marks. The trouble with the mark was simply that it wasn't circulating as it should. Begin, he said, making demurrage charges, on the notes being used. Money would begin to circulate again and a revival of business would take place.

I have grossly oversimplified my description of what Gesell proposed. His was a seminal mind; he was creative; he had ideas, as his writings prove. But it is unnecessary for my purposes to go into details about what Gesell proposed. The essential point is that his currency idea was tried and that it worked. But practical as it proved to be, it dealt only with the problem of deflation, with the conditions created by the fact that money was not circulating as it should. Since purchasing power of the mark was constantly rising, everybody hoarded their marks. Nobody spent them or invested them because they could get more for them by hanging on to them and using them later—in the future when they could buy much more with them. Nobody spent them unless desperation required them to do so—because they were

fearful that they would be unable to earn any more of them. Nobody hoarded Gesell's currency. Everybody spent it, if anything faster than they had spent their money before the depression.

Ingenious as is the idea of such a currency and practicable as it proved to be during a deflationary depression, the acid test of Gesell's idea would have been what would happen with such a currency during a period of inflation, just as the acid test of what I am proposing is what would happen to a currency like the constant during a period of deflation. The acid test of any currency is not circulation but stability. The crucial question is: is its purchasing power constant? If it is, people will buy and sell and conduct their transactions with each other without either cheating or being cheated by the currency they use.