Guest editorial

Why do the banks collapse?

ED NOTE: The following guest editorial originated in an exchange of letters between the editor of Groundswell, acting as editor of a book to be called How History gives birth, which will emerge from last summer's conference at Philadelphia and be published in London next spring, and Dr. Mason Gaffney of the University of California, Riverside, who was a major speaker and whose paper will appear in the book.

by Mason Gaffney

This crazy business of speculative land collateral for bank loans is the most neglected point in our business.

First, Henry George never dealt with it, at least not in his major books.

Further, in 1933 Prof. Herbert D. Simpson of Northwestern University said to the American Economics Association “the banking collapse is basically a real estate collapse.” Ernest M. Fisher of the University of Michigan said about the same, at the same meeting. No one could disagree with what was then obvious.

But no one followed up, either. On the contrary, not one professor of money and banking, or finance, has said boo on the subject since then, except to belittle the matter and lay the blame for the crash elsewhere.

Third, the University of Chigao hired one Lloyd Mints, as Professor of Money and Banking, who made a career out of belittling the “commercial loan theory,” the idea that banks should stick to “self-liquidating” short term loans on inventories of rapid turnaround. Mints traced the issue deep into English history. The Mints legacy was passed on to Milton Friedman.

A fourth development, Friedman, with Anna Schwartz, wrote a long history of banking, blaming The Great Crash solely on the machinations and ill-timed blunders of a handful of Federal Reserve Bank governors. This view is called “monetarism”—extreme monetarism. Friedman hardly mentions any real estate crash. To him, it and the stock market crash were merely echoes of Fed policies, wholly lacking independent causative force.

Friedman’s views were eagerly devoured by the business community and its academic camp followers. They seemed to answer the dirigisme mantra: “Oh Yeah? If the market is so good, what about the Great Crash?” The monetarist rationale exonerates the market; The Crash resulted from wrongheaded monetary dirigisme to be replaced with automatic controls governed by fixed published rules.

Fifth, faced with Reagan deficits, Chicago came up with the “Ricardian Equivalence Theorem” and “rational expectations.” The first rationalizes public debts; the second rationalizes everything.

And finally, it all unravels with the great Savings and Loan collapse. Except that the happy-face Bailout is obviously designed to cover up, to turn the collapse from a bang to a whimper. It’s worked before; let’s try it again.

One reason it worked before is because no one, but no one wrote a good book showing how the banking collapse was a real estate collapse. Not Harry Gunnison Brown, a monetarist (he made some tentative motions, but backed off); not Herbert D. Simpson; not Ernest M. Fisher, too much the Milquetoast; not Homer Hoyt, too busy making money; not any Georgist, they were off chasing neo-anarchism with Albert J. Nock and Frank Chodorov; not Lauchlin Currie, he agreed with and even anticipated Lloyd Mints.

Nearly everyone teaching Money and Banking today was miseducated by the followers of Mints, Currie and Friedman. So where do we look for a fresh analysis?

James Poterba of MIT (who was also a speaker at the conference) has what it takes, except for an obvious appetite for money and inside-manship.

Professor David Felix of Washington University at St. Louis, has written with deep understanding on the matter. But he is prolix and digressive, hard to nail down, Worth encouraging, though.

I would scour the country, and the world, for the right person if I knew we had the movement with all its resources behind us.