ONLY YESTERDAY, SINCE YESTERDAY, AND THE AMERICA THAT NEVER WAS

Part II

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To a nation desperate for solutions, the door had opened for serious people to challenge conventional wisdoms and the accepted principles upon which *the American System* rested. Andrew Mellon, the former Treasury Secretary, told the nation's business leaders there was nothing "wrong with the social system under which we have achieved, in this and other industrialized countries, a degree of economic well-being unprecedented in the history of the world."(1939, p.57) Those experiencing the most serious deprivation were less sanguine. Farmers organized to prevent foreclosure sales and bankruptcies. In the absence of wages, people began to organize the exchange of goods for services and services for services, a return to barter. Various schemes for local currency systems and cooperative enterprises emerged. And, then, after the election of Franklin D. Roosevelt to the Presidency, self-styled conservatives anxiously awaited what changes he would make, fearing the influence of interventionist economists such as Rexford Tugwell.

President Roosevelt promised a *New Deal* for the nation. The Federal government would now assume authority and take responsibility for dealing with economic recovery. Bankers descended upon Washington arguing their case to allow their bank to reopen. Raymond Moley and others debated the possibility of the government directly issuing script, which was ultimately discarded as a way to inject purchasing power into the economy. A bill for the free coinage of silver almost passed in the Senate (over the opposition of Roosevelt). Instead, Roosevelt abandoned the gold standard and ordered an embargo on the sale of gold. An additional law "forbade the issue of bonds, governmental or corporate, payable in gold, and which abrogated all existing contractual obligations to pay bonds in gold."(1939, pp.92-93) The U.S. dollar was then devalued, in part by "progressively raising the price which the United States would bid for gold." (1939, p.93) All this activity took place in 1933, and six years later Allen reflected on the results:

> "[T]here would seem to be room for the somewhat cynical comment that of all the economic medicines applied to the United States as a whole during the nineteen-thirties, only two have been of proved general effectiveness, and both of these have a habit-forming tendency and may be lethal if too often repeated: these two medicines are devaluation and spending." (1939, p.93)

Action has been taken, and initially the results of devaluation seemed promising. Prices and business activity increased. Farmers were offered payments to leave part of their land unplanted. Public works projects were funded, including the construction of dams in the Tennessee Valley to bring electricity to rural communities. Relief funds were approved to deal with unemployment. The Federal government began to provide mortgage insurance to protect banks from losses on farm and residential mortgage loans. Modest savings deposits in the banks were insured. Commercial banking was separated from investment banking. Collective bargaining by unions was made law. And, as young economists came into the government they embraced the notion of economic planning. To Allen, the net effect of all of these measures was "a strange jumble of theories" (1939, p.97) at the same time deflationary and inflationary. Moreover:

> "The financial reform measures sought to discourage concentrations of economic power; the NRA – in practice – tended to encourage them." (1939, p.98)

And, with all of the contradictory implications, the nation was also adjusting to the renewed legalization of alcoholic beverages.

An atmosphere of renewed confidence brought speculators back into the stock market, and prices surged upward through the early months of 1933 before experiencing a major correction. What speculators and even more prudent investors had not factored in was the length of time required for Federal funding to find its way to ground-breaking for public works or into the hands of businesses and workers. Aggregate demand failed to materialize, which increased the tensions between industrialists and the strengthening labor unions. The only idea Roosevelt's team could come up with in response was to spent money buying more gold, hoping to increase prices generally. A key administration economic adviser, O.M.W. Sprague, resigned in protest, as did Dean Acheson from the Treasury. The measure accomplished little beyond devaluation of the dollar and "an embarrassingly huge accumulation of gold in the underground vaults of Fort Knox in Kentucky: over fourteen billion dollars worth of it, at the $35-an-ounce price which the United States was willing to pay…" (1939, p.134)

What most orthodox economists argued was that markets would find the right price level to stimulate renewed production of goods and services. Attempts to support prices by the measures being introduced would, in the longer-run, fail. Roosevelt had backed himself into a corner. "He had committed himself to recovery through rising prices and large-scale business expansion," observed Allen, "rather than through falling prices and the writing-off of debts." (1939, p.135) This was not exactly Keynesian demand management, but the strategy was pulling the nation in that direction. Year-after-year government spending increased, but the thought of committing to a balanced budget was never seriously considered. Allen agreed that this was not possible without further damage to the economy:

> "If it had been possible for the law of supply and demand to work unhindered, prices and wages – and the volume of corporate and private debt – would theoretically have fallen to a 'natural' level and activity could have been resumed again. But it was not possible for the law of supply and demand to work unhindered. In a complex twentieth-century economy, deflation was too painful to be endured." (1939, p.180)

What was needed at this crucial time were policies that would have discouraged speculation by removing the potential to profit without actually (continued on page 12)

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producing real wealth (i.e., goods). One person the Roosevelt team might have listened to was the philosopher John Dewey. In a radio address delivered in 1932, he offered this:

> "The one thing uppermost in the minds of everybody to-day is the appalling existence of want in the midst of plenty, of millions of unemployed in the midst of idle billions of hoarded money and unused credit, as well as factories and mills deteriorating for lack of use, of hunger while farmers are burning grain for fuel. No wonder people are asking what sort of a crazy economic system we have when at a time when millions are short of adequate food, when babies are going without the milk necessary for their growth, the best remedy that experts can think of and that the Federal Government can recommend, is to pay a premium to farmers to grow less grain with which to make flour to feed the hungry, and pay a premium to dairymen to send less milk to market.
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> "Henry George called attention to this situation over fifty years ago. The contradiction between increasing plenty, increase of potential security, and actual want and insecurity is stated in the title of his chief work, *Progress and Poverty*. That is what his book is about. It is a record of the fact that as the means and appliances of civilization increase, poverty and insecurity also increase. It is an explanation of why millionaires and tramps multiply together. It is a prediction of why this state of affairs will continue; it is a prediction of the plight in which the nation finds itself to-day. At the same time it is the explanation of why this condition is artificial, man-made, unnecessary, and how it can be remedied. So I suggest that as a beginning of the first steps to permanent recovery there be a nationwide revival of interest in the writings and teachings of Henry George, and that there be such an enlightenment of public opinion that our representatives in legislatures and public places he compelled to adopt the changes he urged."

Frederick Lewis Allen closed his second book with more questions than answers. He understood the fact that "[n]o healthy expansion of the American economy could be achieved without a steady flow of money into new investment (along with a maintenance of popular purchasing power), and this flow was still dammed." (1939, p.267) He thought a big part of the problem was "the general trend toward centralization, toward bigger and bigger units of social and economic action, was affecting business as well." (1939, p.267)

As in the wake of the 2008 financial crisis and collapse of the nation's property markets, the Great Depression opened the door for objective analysis of the cause of the collapse. In neither instance did this occur. The real lessons of history were not revealed or widely understood. In consequence, history has repeated.

John Dewey tried to direct attention to Henry George's analysis of business cycles and the underlying cause of economic depressions. Over the last few years a similar effort has been made by the prominent economist Joseph Stiglitz, who has called for the taxation of the rent of land as key to preventing *asset bubbles*. In 2010 he also assembled a group of financial experts to analyze the causes of financial bubbles and offer a plan to prevent another collapse. I wish I could say their proposals addressed systemic instability.

An important lesson from history is the instability caused by the movement away from receipt banking, that is the circulation of certificates of deposit as paper currency, fully redeemable in a stated quantity of coinage with a standard content of precious metals. This occurred in steps that began with the corruption of the Bank of Amsterdam's role as the global economy's deposit bank in the early seventeenth century. Today's Federal Reserve Notes (and those issued by every central bank) are what I describe as "promises to pay nothing in particular."

One measure that could have been adopted at the 2008 trough of the land market cycle was to prohibit any financial institution that accepts government-insured deposits from extending credit for the purchase of land or of land value as collateral for any borrowing. In the residential markets this would have served to keep land prices down to levels that remained affordable. The clock would have been turned back to when a minimum 20 percent cash down payment was required when purchasing a residential property. The buyer was essentially paying cash for the land parcel and borrowing to purchase the housing unit (i.e., the capital good).

What about a full reserve currency? We should look to history and the period of stable economic growth after the establishment of the Bank of Amsterdam as a deposit bank. A system of deposit banks (public and private, appropriately audited and required to carry insurance to protect depositors) would hold coinage of a standard weight and measure equal to certificates of deposit issued. In the United States, legislation (or, preferably, a constitutional amendment) would require that most of the gold and silver bullion held be converted into coinage that could be used in ordinary commerce. A ratio of, say, 20-to-1, silver to gold content, might work. As other countries moved to do the same, Gresham's Law would be invoked in reverse: sound money would drive out the promises to pay nothing in particular.

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