THE ROOT CAUSE OF UNEMPLOYMENT
Part 1: Destroying the Wage Fund

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Introduction

Economists have failed to find the root cause of unemployment. Keynesians have looked for it in the paucity of government debt. Friedmanites have tried to blame it on the inadequacy of central bank credit. Both orthodoxies were promoted, one after another, as state religion in the United States, with appalling results: destabilizing foreign exchanges, interest rates, prices; wiping out nine-tenth of the purchasing power of the dollar; even more of the value of bonds; not to mention the triggering of an avalanche of debt.

The Austrian school maintains that unemployment is the result of the high-wage policies of governments such as minimum-wage legislation and granting monopoly power to trade unions. However, this policy is more the effect than the cause. It prices less productive labor out of the market. We are looking for causes that hits the high-productivity end of the spectrum as well.

The root cause of unemployment is the coercive legislation making bank notes legal tender. It initiated a slow process that ultimately destroyed the wage fund out of which wages were paid to workers before the underlying merchandise has been sold to the ultimate consumer.

Tale of the cuckoo's egg

1909 was a milestone in the history of money. That year, in preparation for the coming war, the governments of France and Germany stopped paying civil servants in gold coins. To make this legally possible the note issue of the Bank of France and of the Reichsbank had to be made legal tender. Most people did not even notice the subtle change. Gold coins stayed in circulation for another five years. It was not the disappearance of gold coins from circulation that heralded the destruction of the world's monetary and payments system. There was an early warning. The German and French government's decision to make the note issue legal tender effectively sabotaged the clearing system of the international gold standard, the bill market.

European banks of issue were obliged by their Charter or by legislation to back at least 40 percent of their note and deposit liabilities by gold, and the rest by short-term commercial bills drawn on consumer goods moving apace to the ultimate gold-paying consumer. There was an international bill market trading bills drawn on London. It did not matter whether trade routes passed through British waters or bypassed them: financing international trade through London was the hallmark of the highest reliability. For most banks the use of government paper for the purposes of backing the note issue was explicitly disallowed by their charter. The bank had to pay stiff penalties if it could only balance its book with the help of government bonds in the asset column. Bills on London were preferred.

Bills drawn on consumer goods in urgent demand circulated world-wide without let or hindrance before 1909. As goods were moving to the ultimate gold-paying consumer, bills drawn on them 'matured into gold coins' as it were. That is to say, they matured into a *present good*. It is evident that the notion of a bill maturing into a legal tender bank note is preposterous. Both the bank note and the bill are a *future good*. Furthermore, 'legal tender' means coercion enforced within a given jurisdiction but unenforceable outside. Legal tender bank notes were incompatible with the voluntary system based on trade in bills payable in gold coin at maturity. They were bound to paralyze the bill market. The monkey wrench has been thrown into the clearing system of the international gold standard.

Banks of issue continued to use the bill of exchange as an earning asset to back bank notes. Other subtle changes would, however, alter the character of the world's monetary system beyond recognition. The cuckoo has invaded the neighboring nest to lay her egg surreptitiously. In addition to bank notes originating in bills of exchange, bank notes originating in financial bills have made their appearance for the first time. In due course the cuckoo chick would hatch and push the native chick out of the nest. In five years the entire portfolio of the banks of issue consisting of commercial bills would be replaced by one consisting of financial bills and treasury bills exclusively. The commercial bill has become an endangered species. Soon it would become extinct.

Biggest job-destruction ever

Let us now see how governments have inadvertently destroyed the wage fund of workers employed in the sector providing goods and services to the consumer. The wages of these workers were financed through the trade in bills. The emerging consumer good they were handling might not be sold to the ultimate consumer, possibly for another 91 days. Yet in the meantime workers had to eat, get clad, keep themselves warm and sheltered. They could, thanks to bill-trading that would keep their wage fund replenished.

In order to create a job capital must be accumulated through savings. This applies to fixed capital deployed in making both producer goods and consumer goods. In case of the former it applies to circulating capital as well. But if circulating capital had to be accumulated through savings in the case of consumer goods production as well, then jobs in that sector would be few and far in between. In the event they were plentiful, for circulating capital supporting jobs in the consumer goods sector could be financed through self-liquidating credit that did not tie up savings. By contrast, jobs in the producers goods sector could not be financed in this way, explaining why they were not nearly as plentiful nor as easily available.

Starting in 1909 the governments of France and Germany stopped paying civil servants in gold coin, and made bank notes legal tender. Simultaneously, they let their banks of issue dilute the bill portfolio by admitting finance and treasury bills to back the note liability. People who are color-blind to the difference between liquid and non-liquid banking assets see nothing wrong with that. However, when commercial bills were 'crowded out' of the system, the wage fund was effectively destroyed. Workers in the consumer goods sector could no longer be paid before merchandise has been sold to the ultimate consumer. The liquidity of finance and treasury bills was no match for that of commercial bill. For them, the bank portfolio was a shelter against "the slings and arrows of outrageous fortune". They could not face the music on their own outside of the shelter. At maturity they had to be rolled over if there were no voluntary takers for them. If they were paid, it would be at the convenience of the debtor, which had nothing to do with the needs of the workers. Financial, treasury, and other 'anticipation bills' were unsuitable for backing the wage fund. They served the convenience of the debtor, not the needs of the creditor, in this case, the workers. Workers had to eat. Unless bills in the wage fund were self-liquidating, they might as well go hungry until their products could be sold for cash.

What you need is highly liquid earning assets that the bank can sell by payday so that wages may be paid out of the proceeds. Commercial paper in the portfolio filled the bill. It represented the most liquid earning assets the bank could have. Banks all over the world were competing for them as they wanted to exchange their excess gold for liquid earning assets maturing into gold. Commercial bills were universally acceptable as backing for bank notes. The wage fund was secure. But as backing for the note issue was diluted in the wake of legal tender legislation, the wage fund went up in smoke. *This was the biggest job-destruction in history.*

Path of vindictiveness

Unless governments were prepared to assume responsibility for paying income to wage-earners, there would be unprecedented unemployment that would spill over to all other sectors and all other countries as well. Eventually the governments, to avoid undermining social peace, decided to do just that. They invented the so-called ‘welfare state’ paying so-called ‘unemployment insurance’.

Note that the unemployed could have found jobs, had the clearing system of the gold standard, the bill market, been allowed to make a come-back, and had legal tender laws been rescinded after World War I. The resurrection of bill-trading would have resurrected the wage-fund as well. Instead, the victorious powers chose the path of vindictiveness. They did not want multilateral trade, which might have benefitted their former adversaries as well. They wanted to punish them with bilateral trade, even if it meant punishing themselves. What they have forgotten was to calculate the extent of punishment they were inflicting upon themselves. Their decision favoring bilateral trade and abolishing the international bill market was the cause of the collapse of the gold standard, and the cause of the world falling into the abyss of the Great Depression, making unemployment endemic.

The government started sponsoring ‘job creation’, mostly of make-belief jobs. But what has been hailed as a heroic job-creation program appears, in the present light, a miserable effort at damage control by the same government that has destroyed those jobs in the first place. Economists share responsibility for the disaster