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# THE SIXTH PILLAR OF SOUND MONEY AND CREDIT

## THE PRINCIPLE OF NO PRIVILEGES WITHOUT RESPONSIBILITIES

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### A Venetian Tale

*Once upon a time, in the fair city of Venice, there ruled a wise and just Doge. He had observed and learned much about his people, about himself and his power. So he let his people go freely about their business, but he granted no privileges without charging the privileged with countervailing responsibilities. One day three men asked for an audience, "0 great and wise Doge," they cried, "we are sorely troubled and in need of your help." The Doge asked what was troubling them.*

*"I am a mason." said the first man. "I lay bricks for fine houses. Yet I am idle for the people will not pay my price." The second continued: "I am an artisan. I make many useful artifacts. I use great skill and labor, but the people refuse to pay my wage." The third man stepped forward and said: "And I am a banker. I advance monies I am entrusted with to the mason and to the artisan. But the people won't wait until the mortar sets and the artifacts sell. They demand their money back before my investments come to fruition."*

*"I can see that your plight is great," said the Doge, and he ordered his attendant to bring forth three swords. "You shall go forth and compel those who will not deal with you voluntarily to submit to your terms, for the stronger reason of the sword."*

*"No, no. your Honor," the three men cried, "this we did not ask. We are no highwaymen. We are men of honor. We could not fall upon our fellow countrymen to compel them to our will with the force of the sword. It is you, O wise Doge, who must use power on our behalf. Your power is great."*

*"Perhaps," said the Doge. "perhaps my power is great, but I must use it wisely or else it will be lost." He went on: "You ask me to do what you would not do because of honor." Then he turned to the banker: "Is honor one thing to the banker, and another to the magistrate?" He continued: "My power is a privilege encumbered with grave responsibilities. The charter of your bank confers a great privilege upon you. But your privilege is also encumbered with important responsibilities. You must invest the funds entrusted to you in a manner that they remain accessible to your patrons. You may not sink liquid funds into brick and mortar. You must invest in merchandise that keeps moving."*

*The Doge dismissed the three men with these words: "I, too, am an honorable man. What is dishonorable to you, will never be less dishonorable to your magistrate."*

## The promises men live by

At the heart of the irredeemable paper money system of the United States is the fact that the Treasury and the Federal Reserve banks issue promises to pay which they do not redeem, do not intend to redeem, nor have they got the resources to do so. In other words, the Treasury and the Reserve banks have been given the privilege to issue promises and, at the same time, they have been freed from all responsibility to redeem these promises. Both of them wish to keep their favored position.

A vitally important question arises here: On what defensible ground can any institution claim the right to issue promises to pay and at the same time insist that it should not be compelled to redeem those promises? We have built an intricate legal system in respect to contracts, based upon the elemental and widely- accepted standard of morals, ethics, and common honesty, to the effect that the maker of promises to pay must also assume the corresponding responsibility. We prosecute individuals and institutions when they attempt to avoid the fulfillment of their responsibility.

Harry Scherman, one-time president of the Book-of-the-Month Club, wrote a penetrating book called *The Promises Men Live By*. It dealt with some fundamental requisites of satisfactory and honorable social and economic intercourse. He noted that when men's promises cease to be good, trade and production are hampered, credit collapses, people cannot buy, sellers cannot or will not sell, chaos and social degeneration follow, if not immediately nevertheless, inevitably.

## Complacency and connivance

The commercial banks of this country create deposits against their assets, which are payable only in irredeemable currency. As a fraternity. these banks, by their failure to make any concerted effort to end irredeemability have become accomplices of the Treasury and the Federal Reserve banks. There have been a few concerned and upright bankers who fearlessly spoke up against the false and dangerous principle of privilege without responsibility. J.H. Frost, Chairman of the Board, Frost National Bank, San Antonio, Texas, in an address said, in part: "It would seem that bankers, as the custodians of the people's money, should be more interested than any other class of the population in the maintenance of sound money. Curiously enough, however, the history of most, if not all, of the disastrous inflations of the past indicates that bankers have usually been quite complacent - and often have cooperated in producing monetary inflation. This seems to be largely due to the fact that the liabilities of banks are all monetary and can be discharged by payment in the monetary unit no matter how far the depreciation of its purchasing power may have progressed. I believe that, if the bankers of America really understood what was happening to the people's money they would arouse themselves and demand and finally effect a return by this country to a sound currency redeemable in gold." (The Commercial and Financial Chronicle. May 27, 1948.)

## Holes in the balance sheet

It is an arresting and disturbing picture to see the banking fraternity supporting irredeemable currency seeking special privileges for themselves while avoiding the corresponding responsibilities and, as custodians of the people's money, resisting the most basic step that could be taken to terminate the depreciation of the people's money - a restoration of the obligation to redeem promises to pay.

This is not merely a moralistic observation, but a pragmatic one. Redeemable currency used to be the agent ferreting out unsound and uneconomic debt and liquidating it before it had a chance to metastasize. Banks were greatly limited in their power to shelter bad debt in their balance sheets through incompetence or design. Depositors could, by withdrawing the ultimate bank reserve, gold, force the bankers to maintain the highest standards of liquidity and solvency.

Irredeemable currency on the other hand, makes it impossible for the depositors to discipline the erring or dishonest banker. Previously, the depositor could opt out of the banking system altogether by withdrawing and holding gold, if he thought that the banks had become unsafe. By contrast, all he can do under the regime of irredeemable currency is to move his funds from one unsafe bank to another which momentarily appears less unsafe.

As a result, the banks now have huge holes in their balance sheets, as the market value of their assets is way below their liabilities. For the time being, they keep themselves afloat either by throwing good money after bad (that is, they increase the amount of non-performing loans by the interest due, which is precisely the mechanism behind the metastasis of bad debt), or by tricks such as selling their headquarter buildings and paying out the proceeds as shareholders' dividend. But the day of reckoning, while it can perhaps be postponed, certainly cannot be avoided.