A Debate Over Monetary Reform

Edward J. Dodson

[The following is a partial transcript of an online Land-Theory discussion that occurred at the end of June 2003]

MASE GAFFNEY: One hazard that our present ways have created is the use of land value as collateral for bank loans, and the dependence of the money supply on bank loans. Our monetary theorists should go to work on that one - it is a big subject.

FRED FOLDVARY: Some Austrian-school theorists are on the cutting edge of such studies. They show the faults of central banking and fiat money, and analyze the remedy, free banking (free-market banking with no central bank), and commodity-based money.

STEPHEN ZARLENGA: Fred, those are assertions in praise of your fellow "Austrians," but in my viewpoint, the only thing that such theorists are on the "cutting edge" of is a giant leap backward, and I give five reasons why, summarized in the George study, taken from Chapter 16 of my new book, The Lost Science of Money.

ED DODSON: Mase is, in my opinion, exactly correct about the use of land value as collateral for bank loans. Bankers are frequently lulled into a false sense of security by the upward movement of land prices. This is a very serious problem, still, with regard to construction loans made to developers, when the banks rely on appraisals rather than a conservative forecast of cash flows coming from the property. After the last round of bank failures in the late 1980s, the regulators finally imposed some restriction on how much a bank could lend toward site acquisition (as I recall, it is 65% of the appraised value of the site, which still means that the risk is fairly high). In the realm of residential lending, private mortgage insurance companies take the top exposure to losses and the homeowner/mortgagor pays an annual premium to the insurance company. As the cash contribution requirements and reserves after closing requirements have been reduced, the premium charges have increased. At the same time, the use of sophisticated credit risk models fed by huge amounts of performance data have resulted in fewer and fewer losses associated with defaults. It should be said, however, that we have not endured a prolonged and deeply-penetrating recession here in the U.S., which would certainly test the stability of the finance system.

****

FRED FOLDVARY: With free banking, private banks issue money substitutes in the form of paper notes or bank accounts, convertible into base money, and issued only to the extent that the public desires to hold such money substitutes.

STEPHEN ZARLENGA: By this point Fred, you have gone against several of George's major monetary positions including his continually stressed position to distinguish money from wealth; his pointed distinguishing of money from credit; his well informed condemnation of the "free banking" of his day; and his abhorrence of granting special privileges to bankers (or others). All these are part and parcel of what is called "free banking," which is not to say that free banking has been properly defined. Your short description is fine to identify it in an email, and readers may believe that it is consistently defined in substantial detail elsewhere, but I have found (one of the 5 points) that the free bankers have not consistently defined either free banking, or money.

ED DODSON: The key question of law is whether banks must hold or hold claim to whatever good or basket of goods is accepted as "money." The strongest argument against banks of deposit holding precious metals is that this removes these precious metals from exchange and use in the production of goods. Precious metals are recognized and accepted globally as a storehouse of value; however, there is no reason why a bank of deposit could not acquire precious metals and then lend those precious metals out to producers, who would be contractually obligated to return the precious metals at some future date (plus a user charge). The collateral for the loan of this money could be other assets of equal value, an assignment of cash flows, or the assets of an insurance company that issues a policy to the borrower. What the law should not permit a bank of deposit to do is issue general obligation notes (i.e., uncollateralized debt) as a money substitute. When a bank of deposit makes a loan to a borrower, the bank is transferring the exchange value of a specific quantity of precious metals to the recipient. Subject to appropriate oversight by the insurance industry, by shareholder-appointed auditors and by government regulators, there is no reason why there cannot be numerous banks of deposit operating safely and soundly under these conditions. This would constitute a system of private banking that eliminates the problem of the self-creation of credit (i.e., the printing of promissory notes backed by nothing in particular).

****

FRED FOLDVARY: In my analysis, there is no way to reform central banking. It is inherently faulty and creates more instability than it cures. We need to replace it with free banking, which would include local currencies, LETS (local exchange trading systems), etc.

STEPHEN ZARLENGA: It was for good reasons that we began moving away from free banking 175 years ago, and George gives a number of them as cited in the George paper. Henry George was pretty familiar with types of LETS plans - he even set one up in an emergency for his friend Tom Johnson. But he never viewed it as more than a temporary crisis remedy. On the other hand he did favor a centrally controlled monetary system, but emphatically, controlled by government not under private control. As my paper on Henry George's Concept of Money notes, George was an informed and lifelong supporter of the Greenback system. "I'm a Greenbacker but not a fool!" he once remarked (citations in the study).

ED DODSON: All around the globe today there are currency-starved communities. The situation is getting worse because less and less is produced locally that is exchanged locally. Thus, the currency or bank balance equivalent is not deposited in the same community in which purchases of goods are made. The purchasing power continually leaves these communities to be deposited into corporate accounts and distributed to executives and employees at some other part of the globe. LETS plans are critical alternatives that encourage local exchanges -- keeping purchasing power circulating locally.

I go further than Fred has in his comment above. The link between central banks and government treasury departments amounts to the legal authority to issue counterfeit money substitutes. When the U.S. Treasury issues bonds, the only legitimate source of investors ought to be holders of currency and/or bank balances that are fully backed by some basket of commodities or precious metals. The situation today is that if Alan Greenspan believes that printing more Federal Reserve Notes to give to the U.S. Treasury in exchange for bonds will not cause too much of a depreciation in the exchange value of these Federal Reserve Notes, there is nothing to prevent the Fed from doing so.

****

FRED FOLDVARY: The three great economic reforms need to be the public collection of rent, free trade, and free banking.

STEPHEN ZARLENGA: George (and I) would certainly say YES to one (pub. col. of rent); perhaps NO to two (free trade), if you mean it the way I think you do, but that would depend largely on your clarifications; and emphatically NO to three. Again there is a substantial discussion of the free trade aspect of Georgism in the study, that some Georgists may dispute, and others will agree with. There is also a suggestion therein on resolving those differences and the particular responsibility that now falls on those calling for "free trade", the first being to better define it. Just slapping a label "free" on something has worked for a long time in gaining knee-jerk, unthinking support for it. No more.

ED DODSON: George was certainly clear that without the public collection of rent, removing barriers to exchange (i.e., "free trade") would not work to solve the unjust and inequitable distribution of wealth.

****

FRED FOLDVARY: Unfortunately, some Georgists do not believe in true free trade in money and banking. They think that centralized planning works in money where it failed in everything else, and that the fiat wizards have the wisdom to correctly forecast many months into the future. They also don't understand what interest is and how it relates to capital and money, and why it is so important to have a market-set rate of interest, not manipulated by central bankers. As the kids say, we need to "keep it real".

STEPHEN ZARLENGA: It is not so much a question of what "some Georgists" believe, but of what Henry George himself thought. The fact that we are still talking and writing about him over 110 years after his death demonstrates that his thinking obviously struck deep chords in humanity. He is what has brought us together on these email lists, and therefore his ideas, especially when deeply held, should not be so easily cast aside. They deserve much closer examination. And yes we agree - real is good.

ED DODSON: I concur with Fred that history is on the side of those of us who want a privately-run system of money, banking and credit -- but one with effective regulation and oversight, as I have outlined earlier. I do differ with Fred's comment above, in that the rate of interest paid on savings and charged on borrowing is much more a function of market forces than ever before in the modern era. The central banks can attempt to utilize their limited powers to influence the supply of credit, but their ability to work with government treasury departments to self-create credit is limited by the ability of holders of currencies to hedge, engage in arbitrage and counter any action by government that jeopardizes their expected returns on investment.

Contrary to what Stephen might believe, few thoughtful "Georgists" accept without critical analysis everything that Henry George had to say on every subject. Yes, George wrote in *Social Problems* that "it is the business of government to issue money." (p. 178) He does not spend any time supporting his conclusions that to "leave it to every one who chose to do so to issue money would be to entail general inconvenience and loss, to offer many temptations to roguery, and to put the poorer classes of society at a great disadvantage." Well, all of those observations were more or less true during his lifetime and before. Yet, George also acknowledges the dangers of government monopoly. He makes his case on a wholly different basis: "Instead of belittling the dangers of adding to the functions of government as it is at present, what I am endeavoring to point out is the urgent necessity of simplifying and improving government, that it may safely assume the additional functions that social development forces upon it. It is not merely necessary to prevent government from getting more corrupt and more inefficient, though we can no more do that by a negative policy ...; it is necessary to make government much more efficient and much less corrupt."

Our government at all its levels is arguably less corrupt in some ways than it was in George's time, but more corrupt in other ways. Writers on U.S. history consistently remark how markedly the quality of statemanship and civic leadership declined in the century following the nation's creation. Government served and were in the pay of monopolistic interests. This reminds me of the seminal work by Max Hirsch -- *Democracy Versus Socialism* -- in which he wrote:

"Moreover, while the task of consciously directing the performance of these social functions vastly transcends the power of the best and wisest of men, experience proves that those who would be entrusted with it would be neither the best nor the wisest of the men available. Democracies have produced men of great ability and of conspicuous honour to deal with great questions of State. But where democratic governments have undertaken the conduct of industrial functions, the task has generally fallen into unreliable and incompetent hands. Universal experience proves that the more detailed governmental functions become, the more they deal with industrial matters, the less lofty is the type of politician. Abuse of power, neglect of duty, favourtisim and jobbery have been the almost universal accompaniment of industrial politics." (p.287)

****

CHUCK METALITZ: I've been trying to follow these monetary discussions, and I hope Ed or Fred can clarify one thing for me: Under a free banking system, how does the government decide which currency(ies) to accept for taxes?

ED DODSON: I know that Fred has responded, but I have not yet read any of the subsequent exchanges. Government can, of course, pass legislation requiring that taxes be paid in the paper currency of one or more banks of deposit. Based on what backs the bank's currency, the market would establish exchange rates just as now occurs between paper currencies of differing central banks. There is nothing to prevent the Federal government from establishing a government-owned bank of deposit, issuing its own paper currency backed by quantities of the precious metal it already holds, then spend that currency into circulation. It would be interesting to see how many people would cash in the Federal currency and deposit their precious metal payment with one of the privately-owned banks of deposit. The banks would all be competing with one another over how safe and sound and transparent they are.

CHUCK METALITZ: Under a free banking system, how does the government decide which currency(ies) to accept for taxes?

FRED FOLDVARY: Under free banking, the government does not establish or privilege any currency. Taxes are accepted in whatever currencies circulate or can be reasonably converted to what commonly circulates. The government provides a tax credit for any reasonable conversion costs. For example, an American living in Europe would be able to pay taxes in euros. It is a simple matter for the government to either have a euro account or let the taxpayer credit the conversion cost. "Reasonable" means the taxpayer uses an available commonly circulating currency and does not deliberately use an inconvenient non-money medium.

****

JOHN KROMKOWSKI: Ed, Thanks for the thoughtful essay.

A couple of questions:

You wrote about a proposal under which: "The enabling legislation should require that deposit banks maintain adequate insurance to protect investors . . .."

With what would the harmed investors be compensated? Normal government issued money or other non-bankrupt private money (also insured)? In the end, wouldn't the government need to serve as the insurer of last resort? And if so, why bother with adding the additional layers?

ED DODSON: Ed here: Our history is that government becomes the insurer of last resort when private insurers determine that the risks are too great to insure or that premiums adequate to cover the anticipate losses are not affordable to the parties to be insured (i.e., flood insurance for homeowners in flood plains, hurricane zones, etc.). In a system where banks of deposit are the creators of currency in circulation and account balances against which exchanges are made, there would have to be a catastrophic system failure to bring down the system. Insurers today and under a new monetary system would still need to meet minimum financial reserve and capital ratios to continue to take on new business -- to be declared financially sound by auditors. Because every bit of currency would be backed by some specific quantity of goods (or, under a local system, potentially by labor hours) the only serious risks are fraud, counterfeiting and embezzlement. I do not downplay these risks; protecting against them are costs of doing business, and the banks of deposit must charge fees high enough to cover the costs of prevention. The insurance carrier would certainly not keep all of its deposits in one bank. Moreover, insurance companies sell portions of their risks to other investors.

As for whether the Federal government needs to be the insurer of last resort (as with deposit insurance), there is an argument that insuring depositors balances up to $100,000 has given bankers too much latitude to extend credit to very marginal borrowers, such as foreign governments. Take away some of this deposit protection and people will deposit their money only with banks that have the highest financial ratings by independent rating agencies.

****

JOHN KROMKOWSKI: There have also over the years been experiments with private money in the US: script and Internet credits, how do those fit in the history and what can we learn.

ED DODSON: They were very successful, the central banks got upset about it, and the Federal governments outlawed them. Governments haven't yet (as far as I know) figured out how to stop exchanges that go thru the internet, but I suspect there are plenty of people working on the "problem."

JOHN KROMKOWSKI: How does global plastic fit in? (In another post there was discussion about paying taxes in Euros if you were an American living in European. I seldom see or walk around with cash. If I lived in Europe, it would be no different and I'd probably continue to use my current credit card (which ironically is issued by the Wright Patman Federal Congressional Credit Union of which I am a member from when I worked on the Hill nearly 25 years ago) and since I can pay my taxes with a credit card, I don't get the problem.)

ED DODSON: Right. We use currency for purchases made in smaller and smaller currency denominations. Debit cards could be mandated for exchanges by members of the same bank of deposit (or affiliated bnaks of the deposit) so there would be no float advantage between the time of exchange and time of actual payment. This would eliminate losses for bad debts, lower net costs of doing business and bring down prices without squeezing profit margins.

JOHN KROMKOWSKI: Finally, I am certainly not up to date or at all knowledgeable about the money question. I mostly don't see what the problem really is. It seem more theoretical and potential (although potential grave), but nonetheless theoretical and potential with an increasingly low probability of meltdown in developed countries.

ED DODSON: Well, every day you hold currency balances in a bank today you are losing purchasing power because the central bank and the government treasury very neatly spend more currency into circulation by the exchange of central bank notes for government debt instruments. The danger, historically, is that this process of the self-creation of credit destroys the purchasing power of those who have currency-denominated savings as a primary form of their personal or business assets. The system rewards debtors and penalizes creditors, as well. I temporarily transfer $100 of my purchasing power to someone via a loan and charge that someone 5% per annum for the use of my asset. At the end of a year I receive $105 in currency back, but in the meantime the government and central bank have expanded the supply of currency in circulation, price of goods and services have adjusted upward, and now I need to use $105 in currency to secure in exchange what $95 in currency would a year ago. Thanks to the government I have been robbed.

****

HARRY POLLARD: Ed, as you know, it seems evident to me that there is a chasm between whatever is used as a measure of value and what is used as an exchange media. What is best for one is generally bad for the other. Purchasing media is in major fashion created on the spot by credit cards or checkbook. It does the job well, doubling or halving in quantity as needed by the exigencies of the market. As you may know, I don't think much of "velocity of circulation".

ED DODSON: My main thought on this whole subject is based on my perspective of history and of the extent to which corruption permeates our socio-political arrangements and institutions. No private person or entity can honestly self-create credit. Others must extend credit.

STEPHEN ZARLENGA: Yes If you mean "private entity", such as a privately owned central or other bank, But further EDJ, and HP, its important to distinguish here between credit and money. Private people can always create credit, and that is usually their business (there can be exceptions). The real problem arises when the credit they create is MONETIZED, through special legal privilege, as the banks have; and that is then all of our business, because that monetized credit they create and control has value because it can draw on the entire workings of society.

As I read the Free Banking advocates (they are not all consistent) some of them want to continue that anti-social process in their operations. Did you notice that while you thought you and Fred Foldvary were on the same wavelength regarding free banking, in fact Fred never answered this very pointed pivotal question.

The main reason that private banknotes were accepted by Americans through much of our history, was that the notes were accepted by government in payment of fees. That served to monetize them. It is well documented. (Tom Jefferson also pointed out another reason - that there was little else circulating in the new nation, and the people had little choice)

When that power to use the bank notes was largely removed by Jackson and Van Buren, state bank note circulation collapsed. That brought on the depression of the late 1830s - worst one in our history till then. Bad and corrupt as the privately issued banknotes were, they still functioned as A substitute money, and Van Buren, with a commodity outlook on money, did not understand (at first) the need to put government money (i.e. real money) in their place. Being of Dutch background, he opted more for a

Bank of Amsterdam model instead of a Bank of England model in his Independent Treasury System.

****

ED DODSON: …… (i.e., temporarily transfer their purchasing power -- either for free or at below-market rates of return because of some philanthropical or societal objective they support, or at a market rate of return because that is what the market will bear. Governments, on the other hand, have enacted laws under the guise of monetary reform and economic stability that enable them to self-create credit. They are legally permitted to issue debt in exchange for central bank currency. Those same laws allow the central bank to simply print more bank notes without producing anything tangible as collateral for the bank notes. If the monetary authorities are very lucky, all of the rest of the world's governments and central banks will be playing the same game with less discipline, the increase in the amount of government spending attached to the currency balance acquired from the central bank will not drive up prices (i.e., destroy the purchasing power of the quantity of currency and credit already held prior to the expansion). Even if the government wins, in the short term, Harry, this is still a process of government-orchestrated theft of property. Is that a power we think is just, that we want government to possess? I hope not.

STEPHEN ZARLENGA: I look at this from a very different viewpoint. Consider for a moment that the problem is not "fiat money". In fact the nature of money, as an abstract institution of society embedded in law (as demonstrated historically and in other ways) is that real money is fiat. As you know I hypothesize and give reasons that even early gold coinage was in one sense a type of fiat money. If you are just exchanging commodities you are still operating in some stage of barter, however sophisticated you may make it.

Consider that the problem, is the PRIVATE creation of fiat money. That is a form of theft, because it takes from society as a whole and inevitably bestows power and riches on those who have usurped the legal privilege to create the private fiat money.

When fiat money, or I should just say MONEY, is created by government, it can be viewed as a form of taxation, the proceeds of which are (theoretically) available to assist the society in question, through infrastructure creation, protection of life and property, and in many other ways that till now have been best done by government. In ways that the citizens would think proper and right. Henry George understood that well.

He also knew how that ideal was not being reached by a longshot. But his answer was not to abandon government to the worst among us, and to smear its operations as one can hear on talk radio at just about any time of the day, seven days a week. George's answer in large part, was to work to improve government. (all this is visible in my George paper at http://www.monetary.orghenrygeorgeconceptofmoney

HARRY POLLARD: However, important to every kind of purchasing media is the measure of value that provides the unit of account. All my transactions in Vegas were made in terms of a "dollar" that is supposed to be worth about the same day after day.

ED DODSON: The key phrase is "supposed to be". You trust that the government and the central bank will not do something out of expediency that will have the effect to taking away your hard earned (all that labor sitting at the gambling table or slot machines) purchasing power -- more likely, the gambling casinos purchasing power just acquired from your gambling activity. Why should we be dependent on the [historically absent] integrity of government officials to act in the interest of the citizenry. History puts me on the side of Max Hirsch, as I quoted in my response to Stephen Zarlenga.

STEPHEN ZARLENGA: What history generally shows is that contrary to common prejudice due to Austrian and other propagandizing that actually began with Adam Smith; in the United States, government issued money has a better performance record than privately issued money, once you examine the facts. Check out Chapter 16 for summaries of examples. This is a big surprise to most libertarians, who on first hearing it are quite incredulous. They point to: 1)the Continental currency, and they are unaware that while our government was authorized to create $200 million of them, and did just that; the Brits counterfeited unknown $billions of them; 2)They have a skewed view of colonial paper monies, based on the writings of one Dr. Douglas, who has been shown to be wrong, for at least 100 years; 3)They think the Greenbacks were worthless paper money, when they were arguably the best money system we ever had. Gold bugs are usually surprised to hear that they eventually exchanged one for one with gold coins. (but that is not why they were good!); 4) They point to the confederate money being worthless - yes that happens to fiat money when the government is destroyed; 5) They point to the French Hyperinflation, again unaware of the massive British counterfeiting; 6)they point to the German Hyperinflation, being completely unaware that it was done by a privately controlled and privately owned central bank, which the government had been pushed out of.

This is why it is so important to study history, and its also why economics has been pushed away from studying history, and into rarified mathematics, dropping morality in the process.

Who have assumed that the Austrians did their homework?

Underneath a lot of this prejudice against government is the attack on government launched by Adam Smith himself, which I show was designed to maintain the monetary power in private, not governmental hands. This attack has become a daily barrage, for example on talk radio, and in more subtle ways. Henry George understood this and offered remedies. (See my George paper)

HARRY POLLARD: The "exchange medium" function of money is taken care of without a problem, yet most of the present discussion is about various exchange media. It seems like endless talk about something that is well in hand. I must say that a "local" currency doesn't appeal much to me. If using it locally will get me a 15% discount off local prices, I might use it.

ED DODSON: Well, Harry, you are fortunate to live in an area where the legal tender economy brings as much currency in as departs to the multinational corporate providers of most goods and services. There are many rural communities in the U.S. and elsewhere in which a local currency, backed by something tangible everyone understands and trusts will be provided under an enforceable contract, is a significant means of generating exchange at a level well above barter.

STEPHEN ZARLENGA: Ed points out a real problem here, which living in upstate New York hits home on a daily basis. The money is flowing to the major money market areas. This is a problem that needs to be addressed. However to stop the dispensation of monetary justice from above, its going to require addressing that problem at that level, at some point. I consider that a first priority.

HARRY POLLARD: I prefer gold, or whatever commodity is picked by the free market as the best for the job. I have no idea why some people don't trust the market. It's a confluence of the free opinions of people.

It's where people's democratic opinions about things are measured not in the fashion of the bloodless opinion polls, but by action and exchange. (Compare: "Do you believe in educational vouchers?" with laying out $39.99 for an electronic back scratcher.)

I dislike 'market baskets'. I don't like government calculations setting a 'value'. Again, I want those specifically concerned in exchanges deciding for themselves what is the best unit.

ED DODSON: The reason I have advocated a basket of commodities to back currency is that a basket of goods is less vulnerable to shocks. The old saying, "don't put all your eggs in one basket" applies. A basket of precious metals -- gold, silver and platinum -- for example, historically has a more stable aggregate value than any one of the metals alone. This does not mean a bank of deposit could not issue currency backed by insured, enforceable contractual obligations to deliver a quantity of oil or coal or natural gas, or timber, etc. etc.; but, the volatility of global prices for these commodities is greater individually than collectively. STEPHEN **ZARLENGA**:. Again, Henry George got this one right over 100 years ago. He implored his readers to make the distinction between money and wealth (Especially in "Social Problems"). Commodities are a form of wealth. Money is an abstract power.

This correct concept of money view goes back much farther than Henry George. We see it also in Aristotle, when he wrote that "Money exists not by nature but by law." (from Nicomachean Ethics), as discussed in Chapter 1.

When you say to "back a currency" you are eliminating the money aspect of it. When the pretense of "backing" was made, with gold and silver; banknotes were convertible on the one condition that not a lot of people asked for redemption. They were really banker's credits improperly monetized and accepted for taxes. That's what gave them value, not the gold and silver that the banks didn't have. Because the metals were often/usually never really there, depending on time and region. That is clear historically. Hope my intrusion has not been too disorderly.

****

DAN SULLIVAN: For example, if one were to use wheat dollars, one would be in continual jeopardy of my tax obligations rising, should the value of gold rise relative to the value of wheat.

FRED FOLDVARY: In practice, in almost all places, a free banking system would evolve into one common unit of account within an economy, because this is what is most convenient, and also because free banking would evolve from the current system, which uses U.S. dollars. So in practice, the problem of privileging a currency with tax payments would be very unlikely. The market would have already moved towards a common currency.

But suppose that there are two currencies commonly circulating, gold dollars and wheat dollars. Each is redeemable into fixed amounts of the commodity. The currencies fluctuate relative to one another.

Suppose the government required that taxes be paid only in wheat dollars. The effect would not be much different than if all the food sellers required payment in wheat dollars, or all the sellers and renters of real estate required wheat dollars. If people spend more on food and housing than on taxes, the government effect would be less than the private effect.

But in free banking, government should not privilege any commonly circulating currency. If there are more than one commonly circulating currencies, government would base the tax liability on a neutral value, such as a set of commodities. For example, the set could be an ounce of gold plus 10 ounces of silver plus 100 bushels of wheat plus etc., or possibly a basket of commonly circulating currencies, similar to the SDR unit used by the IMF, and adopted also by some countries such as Latvia. The basket of commodities and/or currencies would be chosen so that it has little seasonal fluctuation. The wheat or gold dollar value of taxes would be computed based on this standard, and people could pay with either dollars.

DAN SULLIVAN: In either case, all holders of currency that do not directly meet the government's standard are placed in jeopardy, and this reality makes "free banking" an oxymoron.

FRED FOLDVARY: I don't see how that applies to a neutral commodity standard.

DAN SULLIVAN: Thus, if there were to be a commodity-backed currency (which I am not recommending), then gold and other scarce resources would be the worst commodities to use as backing.

FRED FOLDVARY: In free banking, each individual person would be free to decide which currency he wishes to transact with and use for savings. Free banking is not a government standard but the opposite, the absence of any dictated standard. If fiat money serves people best, that is what would circulate. Indeed, free banking would begin with a frozen stock of government fiat money, and then evolve from that according to what works best. We should not confuse a gold standard with free banking.

****

HARRY POLLARD: As a general rule it's better to have economic control of the economy rather than political control. But, economic control means price mechanism control - the free market.

ED DODSON: How does one separate the two, Harry? And, do you know of any instances in history or the contemporary world where government, heavily influenced by those at the top of the economic ladder, has not intervened to significantly prevent the operation of (in Henry George's terms) "a fair field with no favors"? Without just law there can be no free market.

HARRY POLLARD: We both agree that our Georgist society shall run under the general rule of "Liberty and Justice for all" where Liberty is 'Freedom under the Law', and Justice is when the Law applies equally to everyone. These can be expanded a little, but the general thought I think is clear. (It should be noted that "Privilege" is the exact opposite of "Justice".)

The problem with the market is that it leads to decisions that some don't like. When the village has 12 pubs and one church, obviously something is wrong, so a law is passed providing one pub for every church.

There again, you get a much higher income than me - so you should give some of your wealth to me. That's fair, that's just, isn't it? Well, it's political control of the economy and we're agin it.

HARRY POLLARD: The "Free Market" is the best way to produce the biggest pie. "Free Land" is the best way to distribute the pie. "Free Banking" is the best way to handle the bits of paper that makes exchange easier.

Poor banks will not do well in the Free Banking shakedown process. Good banks will build up goodwill and a reputation for honesty and good management. Good banks will probably take over the failing banks (government is not needed for this).

ED DODSON: Now you're making sense. However, some degree of government oversight and reguation is needed. Insurance companies and shareholders must commit to hiring auditors to make sure the managers do not cook the books. And, there need to be strong penalties imposed on those who succumb to embezzlement, fraud, or other crimes of theft.

HARRY POLLARD: I'm easy. However, I get the feeling that shareholders (or their representatives) should take care of their own affairs.

When, as with ENRON, the auditing company is in the fix, there is a problem - but crooks have been around forever. Best way to deal with them is with economic control of the economy. When privilege has been kicked out, corporations will not become so complicated and unwieldy - a condition found everywhere in a politically managed economy.

I like Leonard Read's "Do as you wish, but harm no-one."

Penalties should strike those who harm someone.

HARRY POLLARD: Fractional reserve restrictions aren't needed. I would expect that banks will range from 100% to 1% reserve. The interest you'll earn will range from a safe low interest to a high less safe interest. Pay yer money and take yer choice. Obviously, banks will publicize their reserve policies.

ED DODSON: As I have written earlier, safety and soundness require reserves when a financial institution engages in lending its assets to others with the expectation of repayment. By definition a bank of deposit is an entity that holds tangible assets (or contractual obligations against others to deliver such tangible assets) for all currency issued. A lending institution can only lend what it has in assets, and then only that portion of assets consistent with its cash flow needs.

HARRY POLLARD: There must be science of banking. A good bank needs to keep enough reserves to cover expected needs. If it doesn't keep enough, it will have to borrow from another bank that could be costlier than covering themselves properly. So they will act wisely.

After that, they can obligate themselves to pay as much as they wish. This is how they earn their profit. Isn't that what fractional reserve is all about?

HARRY POLLARD: Banks would issue Purchasing Media as they wish. (Banks don't create "money" unless you are whimsical in your meaning of money.) The point about most Purchasing Media is that it is easily created and destroyed. The credit card slip you write today will be invalidated in a day or two.

ED DODSON: You've lost me a bit, Harry. I agree that commercial and savings banks do not create purchasing power. They can only transfer their own purchasing power to another party. The Fed and the U.S. Treasury exchange IOUs as the means of allowing the U.S. Government to self-create credit and use that credit to purchase goods and services. It is your last point that I do not follow. When I use a credit card to make a purchase, within a short period of time my account is charged and the vendor's account is credited. If I am receiving "interest" on my account balance, I benefit from float for the day or two my account is not charged even though I have received the goods or services. The global economy works with elaborate mechanisms to maximize and minimize float; one could argue that pricing equilibriums automatically adjust to account for float. In any event, once my bank account is charged and the vendor's account credited, the purchasing power shifts but does not disappear.

HARRY POLLARD: Actually my float can be 25 days. I use credit cards for everything -- even relatively small purchases. Each month, on the last possible day, the accounts are paid in full automatically from my bank.

Pricing will cover any cost of floats.

The purchasing medium is created by you and me. It's the paper we imprint with our cards and sign. It goes wherever and is stamped or otherwise cancelled as the amount is transferred to our tab.

Same with checks which are purchasing media that after submission are stamped or otherwise cancelled after transfer of funds whereupon they are returned to us - no longer purchasing media.

That's what I mean by easy creation and destruction of purchasing media. We dare not have a measure of value that can be so easily created and destroyed.

Of course the point I'm making is that the functions so easily attached to "money" -- measure of value and medium of exchange - cannot easily be placed on one thing. They are contradictory functions. Finding one thing to satisfy both functions is a Chines puzzle and is responsible for most of the confusion that accompanies the subject.

****

FRED FOLDVARY: With free banking, private banks issue money substitutes in the form of paper notes or bank accounts, convertible into base money, and issued only to the extent that the public desires to hold such money substitutes.

STEPHEN ZARLENGA: By this point Fred, you have gone against several of George's major monetary positions including his continually stressed position to distinguish money from wealth; his pointed distinguishing of money from credit; his well informed condemnation of the "free banking" of his day; and his abhorrence of granting special privileges to bankers (or others). All these are part and parcel of what is called "free banking," which is not to say that free banking has been properly defined. Your short description is fine to identify it in an email, and readers may believe that it is consistently defined in substantial detail elsewhere, but I have found (one of the 5 points) that the free bankers have not consistently defined either free banking, or money.

ED DODSON: The key question of law is whether banks must hold or hold claim to whatever good or basket of goods is accepted as "money." The strongest argument against banks of deposit holding precious metals is that this removes these precious metals from exchange and use in the production of goods.

STEPHEN ZARLENGA: Ed, it does not occur to you that you are embracing an extremely primitive concept of money, which George understood to be harmful. I strongly maintain that if Georgists would pay serious attention to what Henry George writes about the distinction between money and wealth, that such errors could be avoided (this is clear in my George paper at http://www.monetary.org/lostscienceofmoney.

ED DODSON: Of course, this is a basis for debate. As I have explained in my review of your work, we come away from our examination of history with two very different conclusions of how to solve the problem.

STEPHEN ZARLENGA: Before you can develop a meaningful "free banking" proposition, Ed, you need to have a valid concept of money. You are starting with a false one, resulting from the "relapse to metallism" put over by Adam Smith as discussed in Chapter 12. Henry George knew better!

ED DODSON: I offer precious metals as the transitional medium, not as an ending point. I see no reason why the system cannot function with other commodities backing currencies or even labor units. The system blossoms on the basis of interconnected contractual obligations -- again, with appropriate auditing and insurance safeguards built in.

STEPHEN ZARLENGA: After money is properly defined, then if you want to call it a free banking "movement," you need to have that money concept be consistent among the advocates. It is not.

ED DODSON: Let the markets decide. Let us see if "good money drives out bad" or "bad money drives out good."

****

ED DODSON: Precious metals are recognized and accepted globally as a storehouse of value; however, there is no reason why a bank of deposit could not acquire precious metals and then lend those precious metals out to producers, who would be contractually obligated to return the precious metals at some future date (plus a user charge). The collateral for the loan of this money could be other assets of equal value, an assignment of cash flows, or the assets of an insurance company that issues a policy to the borrower. What the law should not permit a bank of deposit to do is issue general obligation notes (i.e., uncollateralized debt) as a money substitute. When a bank of deposit makes a loan to a borrower, the bank is transferring the exchange value of a specific quantity of precious metals to the recipient. Subject to appropriate oversight by the insurance industry, by shareholder-appointed auditors and by government regulators, there is no reason why there cannot be numerous banks of deposit operating safely and soundly under these conditions. This would constitute a system of private banking that eliminates the problem of the self-creation of credit (i.e., the printing of promissory notes backed by nothing in particular).

STEPHEN ZARLENGA: Are you sure, Ed, that Fred it not advocating the "self-creation of credit" to be used as money? (You see such privately created fiat money is something that I also consider it imperative to eliminate; and Henry George did too, throughout his lifetime) but that is not at all clear from Fred's brief description. If we could all agree on that, it would be a major step forward.

ED DODSON: The self-creation of credit requires the ability to enforce acceptance (i.e., coercion). Few private parties possess this ability. Governments, on the other hand...

I will let Fred respond to your concern over how to prevent fraud and misrepresentation.

STEPHEN ZARLENGA: If you read by George paper carefully (George's attacks on the banking system) or the chapters of my book on American Monetary History), you should understand that Fred's description of free banking is essentially the manner under which banks operated in America for much of the 19th century. Thus, my comment that the only cutting edge the Austrains are near (when they are not cutting onions) is a giant leap backward.

****

FRED FOLDVARY: In my analysis, there is no way to reform central banking. It is inherently faulty and creates more instability than it cures. We need to replace it with free banking, which would include local currencies, LETS (local exchange trading systems), etc.

STEPHEN ZARLENGA: It was for good reasons that we began moving away from free Banking 175 years ago, and George gives a number of them as cited in the George paper. Henry George was pretty familiar with types of LETS plans - he even set one up in an emergency for his friend Tom Johnson. But he never viewed it as more than a temporary crisis remedy. On The other hand he did favor a centrally controlled monetary system, But emphatically, controlled by government not under private control. As my paper on Henry George's Concept of Money notes, George was an informed and lifelong supporter of the Greenback system. "I'm a Greenbacker but not a fool!" he once remarked (citations in the study).

ED DODSON: All around the globe today there are currency-starved communities. The situation is getting worse because less and less is produced locally that is exchanged locally. Thus, the currency or bank balance equivalent is not deposited in the same community in which purchases of goods are made. The purchasing power continually leaves these communities to be deposited into corporate accounts and distributed to executives and employees at some other part of the globe. LETS plans are critical alternatives that encourage local exchanges -- keeping purchase power circulating locally.

STEPHEN ZARLENGA: Yes, the world is starved for money, but that is thanks to a privately-owned and privately-controlled central bank - the solutions which I consider essential, focus on ending such banking privilege and placing it in the hands of the citizenry through the treasury. By the way that was also George's conclusion, even before the Fed existed. Read more George!

ED DODSON: Jeff Smith's "citizens dividend" is the core solution to ensuring that all citizens have a baseline of wealth ownership. People must have the means to produce and exchange goods for goods and for services with other members of the same economy if money is to remain in that economy. The case for local currencies backed by locally-produced goods and services is made by the tendency of existing socio-political arrangements and institutions to generate what we have -- hundreds of billionaires and billions of propertyless and poverty-striken people.

STEPHEN ZARLENGA: Among the problems I have with "LETS" are that they can't stop the monetary injustice from above, and they could draw away the attention of reform minded persons.

ED DODSON: The LETS idea is part of a broader concept of community based on decentralist (i.e, self-sufficiency) principles. Multinational corporations with global production systems have not demonstrated any concern for what happens to communities when they come in, exploit resources, exploit workers, pollute the environment, support corrupt political regimes -- all in the name of profit maximization. LETS is an element of a value system based on cooperative relationships.