ON BANKING, CREDIT, AND INFLATION

SPENCER HEATH*

IT IS OFTEN SAID that what anyone doesn't know doesn't hurt him. Where ignorance is bliss 'tis folly to be wise. But ignorance is not bliss. Ignorance is almost always fear, and our most constant fears are our fears of the unknown. It is what we do not know that gives us most anxiety and pain. We feel helpless in the presence of that which we do not understand. In the world of making a living, in the world of business, that is, perhaps nothing is less understood and, therefore, nothing more feared than inflation. Let us take a look at it. What is it that gets swelled up—inflated?

Now business has to do with wealth, and with the services that create wealth, and all proper business transactions consist in the exchanging of wealth and services for other people's wealth and services. And, during the course of these exchanges, wealth that is of low value (like raw or only partly finished materials) comes to have higher and higher value by reason of more and more services being incorporated in it, or in some way performed upon it, until, at last, there is nothing more to be done to it, and it is then, and not until then, a finished product; for it is then in the hands of its consumer and is then, literally, the consumer's own goods.

So, over the full course of production, there is rising value in a commodity, and in the course of its consumption there is a corresponding decline. During all the complex changes that lead to the final production of

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the goods into the hand of the consumer, it is necessary that a record be kept of their value at each point of sale or transfer. If this could not be done, all exchange would have to be by barter and not by sale, for it is only by assigning values to them that goods can be sold; and markets are places where these values are assigned.

Barter is a transaction that is completed in one act—a completed exchange of goods for goods. But selling and buying divides the exchange transaction into two parts, with an interval of time in between. Goods are first delivered and then, after a time and usually in much variety, other goods are received in exchange. During this interval an account must be kept, and this account is kept either by a transfer of currency or by a transfer of bank credits from the receiver of the goods to him who has delivered them. When, finally, the exchange of goods for goods has been completed by other goods being received in exchange, there is a further transfer of the currency or credits to those who supply the goods finally received and completing the exchange.

Thus we see that currency and credits are only the records—the account keeping—of uncompleted exchanges. They are the symbols of the values of goods, and with every transfer of goods in one direction there is a flow of corresponding currency or credits in the reverse direction. The soundness of the accounts—the honesty of the currency or credits—therefore, depends, first, upon the goods having been given, of which the credits are merely the record (although we call them purchase price) and, second, their soundness depends upon further goods being produced and delivered to support the value, that is, the purchasing power, of the currency or credits.

Now, so long as currency and credits, which are called the instruments of exchange, are created only by the delivery of goods and services they will go hand in hand with such goods and services and will serve as the equitable instruments and measurement for other goods to be received in exchange, and in all this there will be neither inflation nor deflation. But let the account be falsified by any action that increases the amount of currency or credits or obligations, without supplying or performing any corresponding goods or services, and we have inflation. Our books of record do not correspond with our wealth, our increased obligations cannot be met in goods, and our currency and credits lose their value as instruments of exchange, for we do not have the goods in adequate amount to satisfy the increase of credits or obligations. Conversely, any action that cuts down the production of wealth has the same inflationary effect, for it makes a disproportion between the existing currency and credits and the amount of wealth coming into being to satisfy them.

Essentially, then, any action is inflationary that tends to cause disparity between the amount of wealth being produced and exchanged and the currency and credits which are the records of uncompleted exchanges and are, therefore, the measuring instruments by which exchanges of wealth and services are completed. These instruments come into being through the need of keeping accounts in trade and exchange. Traders always create them, hand in hand, with their uncompleted transactions in goods and services. When so created they are called credits.

Credits created by governments are called money and currency. Currency is not issued as the record of any uncompleted exchanges. Unless it has some intrinsic or redemption value, it is wholly fiat and inflationary, and it operates to transfer wealth without giving any wealth in exchange. And by positive enactments of law, nothing but currency is legal tender when public power and authority is invoked to enforce private obligations. Since very few obligations are disputed and very few of these are sought to be enforced by law, it happens that nearly all obligations are met by voluntary transfers of private credits in reverse direction to the flow of goods and services in the course of their exchange. It is here that the system of private banks functions, by its credits and debits, to keep the records and accounts so that goods and services can be freely exchanged.

This has almost entirely superseded their original and primitive function as depositories for the safe-keeping of gold and other valuables. Modern banks keep credits and not actual deposits. Yet they are under legal obligation to pay out actual coin or currency to the amount of all the credits they keep. The anomaly of this is shown in the fact that if the banks of New York City had in their vaults all of the United States currency that there is in circulation, they would not even then be able to meet the claims of their depositors in full. They would fall short about one and three quarters billions of dollars. It is as keepers of the accounts, of the credits and charges, and not as depositaries of money, much less of wealth, that the banks play their important role in the general exchanging of services and goods for other goods and services in which all employment and all production consists.

A merchant or tradesman buys goods and then sells the same goods. But this is only a partial transaction. It is a service, but it is not a completed exchange. The profit he makes is his wages for his services. This profit is in the form of credit in the bank, and it shows what amount or value of goods and services he is entitled to have in return for the services he has given. His piling up of credits is the result not of his accumulation of wealth but of his services in the distribution of goods. There is no completed exchange until the merchant finally receives goods and services in exchange for the services he has put out. In the interval between his giving services and his receiving, it is the function of the banks to keep the necessary account so that the goods and services he finally receives may be justly of the same value as what he has given. What is true of the merchant is also true of every person who gives services or goods and takes money or other credits. His transaction is not completed until he has received goods and services in return. The basic function of the whole system of banking and finance is to keep fair accounts of the uncompleted transactions.

All instruments of credit are the instruments of exchange because they are measuring instruments. They record the measure of the value of what has been given and fix the measure of the value that is to be received. When these instruments are increased in quantity or volume, either by currency inflation or by credit inflation, they become false measures of exchange and, therefore, unfair instruments for that purpose. The result is the same as falsification of any other system of accounts. But as inflation can be perpetrated only by public authority acting directly or indirectly, it cannot be reprobated in the same way, and its injurious effects must fall upon the public at large.

The normal and legitimate creation of credits is through giving goods and services. It is the service we contribute that gives us the credits wherewith we buy, and all our proper deposits in the banks are the records of what we have given and, therefore, of what we are entitled to receive. But governments do not create credits in this way. By taxation, they take existing credits from persons who have become entitled to them by giving goods and services, and transfer them to persons who have not given goods or services. All taxation is merely a transfer of purchasing power. It transfers from those who have given to those who have not given.

Governments make many attempts not only to transfer purchasing power, but also to create it. When they do this, they create obligations without creating any wealth to meet these obligations. They do this by borrowing against the future wealth of their taxpayers. When these public obligations outrun the prospect of the private production of wealth being able to meet them through taxation, they cannot continue to be issued. When this point is reached, either much public spending must stop or government must print and issue the currency that it spends. Such issues are artificially created debts, immediate charges against all present-existing goods and services. It becomes impossible for wealth and services to multiply as fast as the debts against them are created. The debts cannot be met; the credits cannot be made good; and all their value is lost for want of wealth to sustain them. Whenever credits are created without creation of wealth, that is inflation. And unless the production of wealth can keep up with the creation of credits and debts, such debts can never be paid.

The only rightful receiver, receiving as a matter of right and obligation to him, is he who has first been a giver. The only rightful buyer is he who has first been a seller. It is only by the selling or pledging of goods and services that credits can properly be created. Such credits become the records of the sales and are the proper instruments wherewith to complete the exchange by the purchase of other goods and services in lieu of those that have been sold.

Every artificial issuance of credits is a violation of the process and the principle of exchange, for such credits are not based on any goods or any services that have been sold. They assume to create purchasing power other than by exchange. They make those who produce wealth the debtors of those who do not produce. Such debts cannot continue indefinitely to be paid. In the end, there can be no credits or purchasing power but that which comes from the production of wealth and services and the putting of these into the course and channels of exchange. It is, at the last, only by freedom of production and freedom of exchange in unrestricted markets that authentic credits can be established as instruments of exchange. It is only in this way—by freedom of production and exchange—that just and rightful purchasing power can be created and maintained. When this truth becomes well understood, it will be practiced; and all the mystery and all the menace of inflation will have passed away.