AMERICAN REVIEW OF POLITICAL ECONOMY

Volume 3, Number 1

March 2005

AMERICAN REVIEW OF POLITICAL ECONOMY

Volume 3, Number 1

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AMERICAN REVIEW OF POLITICAL ECONOMY

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Silvano Borruso
Strathmore School

ABSTRACT

The author's intention is to show that if economics is to become a social science, analysis has to start with the truth of things, continue with the virtue of justice, and end by assigning their rightful places to the approaches of the past 200-odd years: Liberal, Marxist, Austrian, ecclesial and Georgist-Gesellian. The argument hinges on the Land and Money questions, which modern economics persists in not addressing. Hence the rampant economic disorder. The modern State has been rendered impotent by the vested interests that have succeeded in keeping the two questions under wraps. Conventional solutions of economic problems are grossly defective for the same reason. Two men, neither of them an economist, did tackle the problems and solve them: Henry George (1839-97) and Silvio Gesell (1862-1930). Their solutions: Free Land and Free Money would spell the end of landlordism and usury, thus ending multi-secular oppressions. Oppressors would no doubt put up a stiff resistance.

JEL CODES: B12; B31

KEYWORDS: Henry George; Silvio Gesell; Free Money; Free Land

1. INTRODUCTION

After being thrown out of the IMF in 1999 for whistle-blowing, Joe Stiglitz, ex-Chief Economist of that venerable institution, received the Nobel Prize for

Economics in 2001, for his explanation of how "asymmetric markets" work. An asymmetric market is one where some people know more than others. Had the Nobel Prize existed in Aesop's time, the fox that enticed the crow to speak so as to make him drop his cheese would have easily qualified for it.

The man and his prize are emblematic of the disorder in economic affairs that has been spreading since *The Wealth of Nations.* The past 200 years have increasingly seen what may well be called "the Stiglitz paradox:" parallel to the setting up of university chairs, tenured professors, prestigious textbooks, journals of great erudition, and thousands upon thousands of doctoral theses (published or not), not to mention the Nobel awards, the economy of the real world, suffered in the flesh by countless men, women and children, is a world where poverty reigns side by side with opulence; unemployment rises its ugly head side by side with the need for work; the gap between the rich and the poor widens by the day; and the scourge of war and terrorism goes together with a diminishing freedom caused by the oppressive intromission of the State in personal and family affairs.

Let us add that economists who dare "predict" anything, are always proved wrong, and that neither universities nor government departments dare to sack them as they would if instead of economists they were, say, engineers or accountants, e.g.:

> Just a year ago, top Fed officials (most of them economists) forecast the economy for 1994. On average, they predicted economic growth of 3 to 3.25 percent, inflation of about 3 percent and year-end unemployment between 6.5 and 6.75 percent. In fact, the economy grew 4 percent, inflation was only 2.7 percent and unemployment dropped to 5.6 percent… Economists of all parties have fostered popular delusion by overstating the power of their ideas.[1]

> Economic forecasts are dangerous when they are published and believed – but even more dangerous when they are not published and still believed.[2]

> The trouble is the whole exercise is dishonest; economists don't know enough to predict how a tax cut of, say, $35 billion will alter long term growth in a $7 trillion economy.[3]

> Page after page of professional economic journals are filled with mathematical formulas leading the reader from sets of more or less plausible but entirely arbitrary assumptions to precisely stated but irrelevant conclusions.[4]

2. A NATURAL ECONOMIC ORDER

In minimal terms, a natural economic order is one where those who work eat, and those who do not either get the ravens to bring them food[5] or starve. A natural economic order hinges on the production and distribution of *wealth.*

- *Land, labor, and raw materials* produce wealth. Labor produces *capital* if allowed to do so.

[1] Robert J. Samuelson, *Soothsayers on the Decline*, Newsweek February 13, 1995 p. 44.
[2] *A Plague of Forecasters*, The Economist 21st August 1976
[3] Samuelson, art. cit. p. 44
[4] Wassily Leontief, Nobel Prize winner in economics, cited in *The Economist of* 17th July 1982.
[5] 1 Kings 17: 1-6. By "ravens" here are also meant charitable people who feed those who cannot work.

- There are many means to distribute wealth: trade, the law, especially tax law, and an infinite variety of social intercourse: salaries, gifts, offerings, theft, bribery, unjust privilege, fraud, gambling, and countless other means thought out for centuries by people who intend–and regrettably succeed—in living off the work of others.
- All the foregoing is facilitated (or hindered as the case may be) by <u>money</u>, an excellent invention of the human spirit the history of which is better read elsewhere.[6]

Please note that whereas the laws of wealth production are necessarily *physical*, those of wealth distribution are necessarily *moral*, for they are always the consequence of free and responsible (or irresponsible) human decisions. Economic inquiry ends on ascertaining where the wealth produced ends up. The factors of production: land, labor, capital, and money, act now as receptors of distribution.

A natural economic order should square with

1. The truth of things. Truth, defined as "the agreement between the mind and reality,"[7] must be, as in a court of law, whole and unencumbered.
2. Justice as "the constant will to give everyone one's due."[8] It is therefore unjust not only failing to give what is due, but also giving what is not due.

[6] See J.K.Galbraith's *Money*, Houghton Mifflin Co, N.Y. and S. Zarlenga's *The Lost Science of Money*.
[7] The definition is Avicenna's (Ibn Sina, 980-1037); Aquinas made it his own.
[8] The definition is Papinian's, one of Emperor Justinian's jurists. It has stood the test of 15 centuries.

3. Freedom to take economic decisions, at all levels of society.
4. Solidarity. Man's nature as a social animal entails solidarity, i.e. voluntary *dependence*, not to be confused with loss of freedom.
5. Subsidiarity, the transcendent principle that makes freedom and solidarity *converge*. Without it, they diverge: freedom degenerates into liberalism and solidarity into collectivism.

Even a cursory reading of the foregoing tells that present-day economy is not in any sense an "order," even less a "natural" one. It is a disorder of colossal magnitude, the root cause of which is the abdication of State sovereignty: of land to title-deed holders and of money to high finance.

Many people go on believing the Central Bank and Government act as two placid oxen pulling the economic cart, with the people firmly in the driver's seat gently prodding the beasts into taking the cart in the same direction.

The reality is that the people are the ox pulling the cart, the Central Bank is firmly in the driver seat and the Government is the whip in its hand, hitting the ox with sundry taxation. The commercial banks are akin to horseflies prodding the ox by biting its tender parts. The landlords are the cart itself.

The rest of the paper will be devoted to proving the foregoing thesis.

3. THE LAND QUESTION

A landlord is a *de facto* sovereign. He exercises sovereignty by excising a natural resource (land) from common use and then taxing those who need it to work. Since anyone who works, down to the smallest economic operator in urban setting, needs some soil under his feet, he has to pay rent to the holder of the title deed for that particular piece of land. He may go and occupy free land, but the distance from the market adds to his costs whatever he saves by doing so.

Landlord taxation forms his rent, which he exacts in one or both of two ways:

- From tenants, who pay him directly;
- From workers, by withholding their due wages.

In either case he maximizes rent. A pool of unemployed suits the landlord fine, for if either tenants or workers protest, the threat of unemployment makes them submit. This is the main reason why no government throughout the 20th century has succeeded in eliminating unemployment.

Private ownership of land, which at present indissolubly joins the *ius utendi* to the *ius abutendi* (right of use and abuse) has two main effects.

- It depresses agricultural wages. The best land, closest to the places of consumption, gets occupied first, for uses more profitable than agriculture. Hence the margin of cultivation gets pushed farther and farther from such centers, thus forcing producers to rely on a long chain of middlemen to market their products. The fruits of their labor are thus reduced.
- Monetizing as rent all the advantages of social intercourse. At any improvement in infrastructure, social amenities, technology, that entices the workers to stay rather than emigrate, the landlord either increases the rent of his tenants, or depresses the wages of his workers, or both.

The history of landlordism is a long one. Livy's patricians and commons struggled for centuries about

the very points made in this paper: land and money. Whenever the commons threatened revolt, or were in a position to demand reform, the patricians invariably managed to divert their attention towards enemy invasions, not infrequently causing them.[9] In Church history the same question looms larger, from the land grants of Pepin of Heristal (756) to the loss of the Papal States (1870).[10]

The rise of the modern State, begun with the unfortunate decision of dividing the Fathers at the Council of Constance (1415) by nationality, promoted political landlordism, but the sovereignty of the State was soon usurped by private landlords starting with Henry VIII's imprudent decision to sell off confiscated church lands in exchange for title deeds.

The land question is responsible for the perennial, unresolved tension between sovereign,[11] nobles and the plebs, plus phenomena like European colonization, "overpopulation," the mafia, and war as an escape valve from social unrest.

From none of the above it follows that land ownership is immoral *per se*. Landlords/ladies conscious of the social function of their property have always existed, but admittedly not many.[12] To give on a plate the

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[9] Early History of Rome, from Romulus to the Gallic invasion.

[10] For more than 1000 years the popes had to wear two hats: one as head of the Church and another as king of the Papal States. The interests of the two not always coincided, to put it mildly. Perhaps the most grotesque episode was the war between His Most Christian Majesty Philip II of Spain and Pope Paul IV for the duchy of Paliano in 1555.

[11] This term applies indifferently to erstwhile kings as to modern presidents or what have you.

[12] An outstanding example is Marchioness de Colbert of Barolo, 1791-1854, main benefactress of Don Bosco (1815-88) in Turin. At 53 she wore the cilice of penance under her dress, dedicating herself exclusively to the poor. In her *Memoirs* she

opportunity to live off the work of others and expect the grantee not to make use of it is rather a tall order.

4. THE MONEY QUESTION

The money question goes all the way back to Croesus of Lydia (6th century B.C.), who took the momentous, but baleful decision to stamp lumps of *electrum*, a natural alloy of gold and silver, with his royal seal, thereby guaranteeing the weight of the money units. Two things escaped him:

- The alluvial deposits of electrum (from the river Pactolus in Asia Minor) would not last forever, and that an economy based on the division of labor would fail to develop unless backed by ever new findings of deposits of precious metals;[13]
- Since gold and silver have "intrinsic value," meaning that everybody likes them as metals, whoever is in possession of one such coin will think twice before spending it. The intrinsic *contradiction* between saving and spending gets indissolubly united in the same lump of matter. Needless to say, whoever controls the monetary raw materials controls money as well.

wrote, "I must pay for my ancestors' unjust privileges. I must settle accounts for the debts they contracted with the miserable and the exploited." For many years she used to spend three hours daily in the women's prison. She endured insults, humiliations, even beatings, for wanting to teach those poor women. In the end she succeeded in getting the authorities to separate the men's prison from the women's.

[13] Silvio Gesell argues that the decadence of the Roman Empire was due to the superstition that money had to be made of precious metals, the mines of which were already exhausted by Augustus' time. The dearth of money caused the collapse of the division of labor, and with it that of the political organization. *Natural Economic Order* Part 3 Ch. 17.

Lycurgus of Sparta (ca. 9th century B.C.) had seen through the scam three centuries earlier, banning gold and thus gaining the admiration and praise of Pythagoras and the reviling of gold buffs. I do not know if Croesus had ever heard of Lycurgus.

The question has not been solved to this day. For all these centuries governments, for as long as they could still do so, issued money as a means of exchange, but they never, ever succeeded in preventing savers and usurers (for the present argument they are the same) from taking money out of circulation for their own purposes. Thus money scarcity, rampant to this day, is the main, though not sole, cause of the economic disorder troubling so many nations, particularly in poor countries.

The dearth of means of exchange gave rise to credit. The first to realize that credit could replace costly (and dangerous) transfers of specie were the Knights Templar. After their expulsion from the Holy Land in 1291 they established an extremely successful network of credit centers in their commanderies throughout Europe, with headquarters in Paris. Of course they did not tell anyone that there was no gold "backing" their pieces of paper, and that was their undoing. King Philip the Fair, in cahoots with the first Avignon Pope Clement V, destroyed the Order and ransacked the commanderies in search of the phantom treasure. In one of history's ironies, pope and king died within the same year as Grandmaster de Molay (1314).

King Philip's (and Croesus') superstition is alive and well. Most people still labor under the same delusion (confusion if you wish), calling "money" both cash and credit. It is true that cash for 100 dollars (pounds, yen etc.) purchases the same goods and services as a check for the same amount, but a check is an instrument of *credit*: all it does is transfer *information* from one account to another, *once*. Cash, on the other hand, transfers goods/services for the value of 100 units *every time it changes hands*. In the hypothesis, unlikely but not impossible, that 100 units of cash were to change hands three times a day for a whole year, *the same note* for 100 units would move goods and services in excess of 100,000 units. This is the meaning of *liquidity*, which cash, but not credit, enjoys.[14]

This has never happened. The cost throughout history has been, literally, rivers of blood. What follows will give an idea, however sketchy, of the real situation.

What enriches a select few at the expense of many is not Government intervention, for the simple reason that Governments have no say over the issue of money except for coins, on which the State exacts a paltry seigniorage (profit from rating nominal above intrinsic value). The production of money has been left to private interests (banking) since Waterloo (1815), when the private banking sector completed its usurping the issuing of means of exchange from the State.[15] And that is precisely what enriches the select few: they are those who control money as store of value, depriving of its use those who need it as a means of exchange, unless, of course, the latter pay them a tribute called "interest."

Few people know, and perhaps will get scandalized on knowing, that the institution of the Central Bank is the

[14] The above should not be construed as a condemnation of the check or of electronic money, which moves much like it. If neither existed, the dearth of liquidity would be far more biting than it is.

[15] The beginning of that usurpation was the foundation of the Bank of England in 1694; Napoleon, conscious that the ruin of France had been the work of Necker and associates, wanted France free of debt, hence the Continental System. He tried military resistance, and failed.

second plank of Marx's 1848 manifesto. The "prince of muddleheads," as Henry George dubbed him, advocated, in his own words, "Centralization of wealth in the hands of the State by means of a national bank with an exclusive monopoly."

The institution has spread from one country to another since.[16] Central Banks issue money as dictated by the World Bank. Present-day policy allows the so-called Group of 12 to have a relatively abundant supply of money, and the rest of the world to survive as best it can by "borrowing" from "donors," meaning that poor countries' Central Banks issue no more local currency than matches the quantities "borrowed." The rationale behind this policy has never been explained. Its effects can be read in Hernando de Soto's *The Mystery of Capital:* the assets of the world's poor, with a total value of 9.3 *trillion* dollars, are like a gigantic engine, seized because of lack of lubricant. This dearth of money keeps poor countries in a permanent state of deflation, with all the social problems entailed.[17]

The commercial banks (in all countries) fill the gap, but they do not issue cash: they create credit, and only for the "credit-worthy," i.e. the select few. They, not "government intervention" "enrich the select few at the expense of the many."

Besides credit, banks also create confusion, out of which they prosper. They call "loans" what are in effect licenses to print money (credit), and love their clients to

[16] Few economists seem to know, or to care, that the dean of all revolutionists should have been the one behind financial power. It is also odd, to say the least, that the revolutionary mobs of the 19th century never touched banks and bankers.

[17] De Soto does not see it that way. He thinks that the assets should be "legalized," by which he means brought into the framework of State laws. Even if they were, their incorporation into the legal system would not solve the deflationary problem by one iota.

believe that their deposits are "sound" because of the few tons of gold ingots kept in their vaults. And so everybody calls various instruments of credit "money", without thinking that such instruments are for one-shot transactions, without circulating as cash does. This crucial qualitative difference passes undetected thanks to modern thinking, brainwashed into believing that only quantity, not quality, matters.

On their (fake) loans, of course, banks demand interest, but without creating it. Interest must be extracted from the economy of production and exchange, which guarantees that somebody, somewhere, must regularly go bankrupt. A paradox of this arrangement is that the so-called "bad" loans, meaning borrowers who fail to pay interest, are bad for the banks, but good for the economy, for the defaulters don't go bankrupt. The same thing can be said about bank robberies: the economy gets injected with much needed cash, in operations that at times cost a few lives.

The issuing of credit and grand scale money-manipulation has brought into existence what Bernard Lietaer calls "the global casino," i.e. a financial bubble of monstrous proportions utterly unrelated to the economy of production and exchange.[18] In 2001 the bubble was worth $98 *trillion*. Lietaer forecast it to be $140 *trillion* in 2004. Since world production and exchange requires no more than $3 trillion, it is not difficult to imagine what would happen if this nightmarish demand were unleashed onto the consumers' market one good day.[19]

[18] Bernard Lietaer, *The Future of Money*, Century, London 2001.

[19] The recent boom in property sales (August 2004) may well have to do with the imminent bursting of the bubble: those in the know have started investing in land. It can be seen that if the two problems of land and money were solved, these gentlemen could well start eating their worthless papers.

Governments have of course tried to get hold of some of this "money." But their impotence has become manifest in their utter inability to impose even the modest Tobin tax of 0.2 - 0.5% to the trillions that cross borders every day.

That money should consist of "unbecoming" paper notes, as opposed to luscious gold, in the opinion of the Austrian School, is irrelevant. The contradiction "means of exchange v. store of value" persists, and that is why hoarders withdraw money from the market and release it if and when they can exact a tribute known as "interest." Put it another way, demand (backed by money) has an undue advantage over supply, thus making nonsense of the homonymous "law."

Deflation and crises that used to hit the economy as soon as the interest rates dropped below 2% have not happened since Bretton Woods (1944), because Keynes (1883-1946) convinced Central Banks to replace hoarded notes with freshly printed ones. A built-in unreliability is thus a symptom of the impotence of governments to control the hoards. If at times there is too much money, and at times too little, it depends on who decides to disgorge, when and what for. That is why, as Guido Hülsmann of the von Mises Institute correctly remarks, "Most people and even most economists have no clue."[20]

Were money still made of precious metals, since no government can make gold or silver, the outcome would be far worse. The demonetization of silver in 1872 (in Germany) was certainly due to intervention, but not by Bismarck. The interventionists were the hoarders of gold, worried that abundant silver could improve the lot of the working classes. Prosperous workers would not

[20] *Nicholas Oresme and the First Monetary Treatise, Mises Daily Article* 18 May 2004

quite agree to being exploited in the interest of landlordism and usury. Scarce gold assured control.

The money question joins the land question in causing the class war, international war, unemployment, political assassinations,[21] poverty, underdevelopment, lack of housing and infrastructure, concentration of energy sources, scarcity in the midst of plenty and a host of other evils that plague the world undetected and therefore unchallenged.[22]

5. THE IMPOTENT STATE

Unable to beat either the land or the money power, the impotent State joined them. Modern taxation began in earnest. As James Robertson puts it:

> After paradise lost, you can almost imagine Satan sitting down with Beelzebub, Moloch, Belial and the rest of his cabinet, to design the most damaging tax system they could persuade the human race to adopt. Could they have done much better than what we have now?[23]

The hallmark of modern taxation is *injustice*, whichever of its features one considers. As George Bernard Shaw once remarked, "A government which

[21] Napoleon, Lincoln, Czar Nicholas II, Trujillo, Kennedy, Somoza, Torrijos and Roldós are good examples.

[22] Underdeveloped countries remain underdeveloped, among other causes, because their politicians see poverty as a source of power. Handing a paltry sum to poor people ensures votes; doing the same with prosperous people would reap insults and scorn.

[23] *The Alternative Mansion House Speech*, 4th September 2000. Robertson@tp2000.demon.co.uk. Robertson was adviser to Prime Minister MacMillan during the famous "wind of change" speech.

robs Peter to pay Paul can always depend on the support of Paul."[24]

The modern State robs Peter in five basic ways.

Customs and Excise is the modern version of robber barons plundering traders. The art of doing so consists in not taking more than will entice the trader to change route. It criminalizes the basic human trading instinct. It acts as a brake on the economy. Henry George remarked that goods spent many more weeks in customs warehouses than in crossing the ocean. Today air transport has dramatically reduced the crossing time, but only for goods to spend more time in customs warehouses. On top of that, a plethora of officials check, authorize, deny, verify, control, stop, and variously exercise power over any unfortunate who does not know the ropes. Not a few of them, on realizing their discretionary powers, demand bribes, thus diverting the fruits of someone else's labor to themselves.

Indirect taxation hits consumption in all its forms. "*Non olet*," Vespasian is reputed to have said on smelling the money accruing to the exchequer from a tax on public urinals. Modern indirect taxation dates from Restoration England in mid 17th century, when the landlords then in power shifted the tax basis from their property onto the consumables of the poor. The practice continues to this day. Gasoline (in Britain) is punitively taxed at 75% of its selling price.

Income tax hits production. Its introduction (by Lloyd George in 1909) in progressive form is not even a century old. As the State has the duty of protecting life

[24] George Bernard Shaw, *Everybody's Political What's What?,* chapter 30, p. 256 (1944) cited in Respectfully Quoted: A Dictionary of Quotations Requested from the Congressional Research Service. Washington D.C.: Library of Congress, 1989; Bartleby.com, 2003. www.bartleby.com/73/. [December 6, 2004]

and property, it has the right to tax life and property. It can be argued (as I do) that income tax is a form of poll tax, therefore counterbalanced by services such as defense, justice, and law and order. It is therefore the less unjust of the taxes of the modern State. It would be more just (and increase revenue to boot) if it were exacted on a flat rate instead of a progressive one.[25]

Value Added Tax hits transactions. It is by all accounts the most unjust and counterproductive, not to say absurd, tax ever devised. It is not even new. 16th century Spain had VAT: it used to be called *alcabala*. It did not last because the Spanish State quickly found out that the cost of collection exceeded the amount collected, thus ruining the economy. Modern bureaucrats know this, but to hide the fraud they saddle compliance costs on producers and traders without paying them. To force people to work without pay is the arrival point of Von Hayek's 1944 *The Road to Serfdom*.

The latest idea to fill the coffers of the State is *legal gambling*. Never mind the increase in crime, bankruptcies, divorce, and child abuse, with a social cost that would offset any amount of revenue collected. To allow Native Americans to pander to the vices of gamblers by running casinos is to dissolve the last feeble ties they still have with the land. Benevolently, let us call it economic myopia. Malevolently, one could well call it covert genocide.

State intervention, a foe of the Austrian School, is the intervention of an impotent State, forced to implement the catch-22 situation described above.

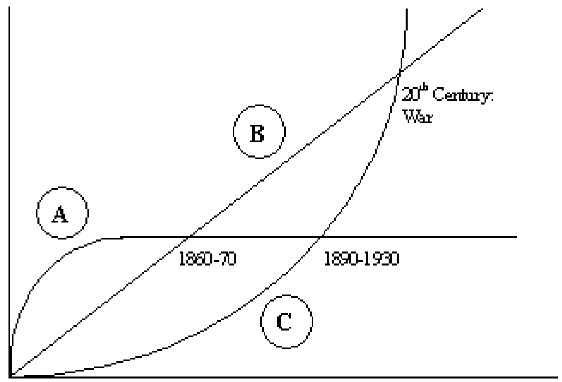
[25] The State harbors the illusion that by taxing income progressively it hits the rich more than the poor. In reality, the rich can afford clever lawyers who help them avoid punitive income tax rates.

The Austrian School was anticipated by the Italian economist Maffeo Pantaleoni (1857-1924), who remarked some 100 years ago that

> Governments have taken to what is called State Socialism and Paternalism, or general tutorship of citizens, creating innumerable State monopolies, privileges; laming private efficiency, destroying speculative commerce and industry, turning into crimes absolutely necessary ways of doing business… Everywhere, more or less, Governments pay a corrupted Press, forming public opinion… Public opinion should be awakened to the economic value of Governmental honesty. Private dishonesty is repressed by courts of law. Unfortunately there are no prisons for statesmen and political bodies.[26]

Graphically, the economic disorder gripping the world can be expressed as:[27]

[26] Daniele Varè, *The Two Impostors*, 1949. John Murray, p.65.
[27] The graph comes from *Inflation and Interest Free Money* by Margrit Kennedy, New Society Publishers, p. 19. Dates are added.



Curve A responds to natural growth, i.e. the growth of living things. It depends on the cycles of nature: water, oxygen, carbon etc. Agriculture and derived industries follow, or should follow, that curve: fast growth at the beginning soon reaching zero growth (equilibrium).

Straight line B represents industrial growth. It overtook agricultural growth for the first time in the decade 1860-70, both in America and England, followed by the rest of industrialized countries.

Curve C is the exponential of compound interest, pushed inexorably by usury, dictated in turn by the form of money in use since Croesus, with the concomitant, permanent confusion between means of exchange and of saving.

The decades 1890-1930 marked the intersection of compound interest with agriculture. The effects have been dramatic not to say tragic. For instance:

- The rape of the great North and South American prairies. Millions of tons of grain below cost were dumped on the European markets, ruining

the small farmers and forcing millions of them to migrate. In the 1930s nature wreaked its vengeance on America with the “dust bowls”: 400 million acres of exhausted land went with the wind (Steinbeck’s *Grapes of Wrath*).
- The replacement of Chilean nitrates at the end of the Great War with synthetic ones. Now forced into continuous, relentless growth by compound interest C, synthetic nitrates function as explosives in wartime and as fertilizers in peacetime. Any good farmer knows that the only rational practice is to feed the *microflora of the soil* with compost made of natural fertilizers. This in turn feeds the roots of the crops in the time and manner established by nature. But for the past 90 or so years the industry has succeeded in forcing the artificial feeding of crops. Quantitative production has been spectacular, but its quality proportionally deficient, unable to sustain the health of livestock and humans. Natural fertilizers are either not produced or they are destroyed, thus giving work to the “unemployed.”
- The invention of the flat-disk mill. This neatly separates nutritious germ from protein-rich bran and plain starch of the wheat grain. The first two sell at exorbitant price instead of going into ordinary bread as they used to. A prisoner on bread and water could survive in ante-flat disk mill days. Today he wouldn’t.
- The disappearance of the family farm by foreclosure, and its replacement with cash crop culture, which increasingly depressed soil fertility.

When exponential C intersects straight line B, it is the economy of war. Production is now in function of destruction, so as to give employment and pay interest on debt. In 1945 Raul Follereau[28] asked both Roosevelt and Stalin for the cash corresponding to the cost of a bomber on behalf of his lepers, but in vain. He did not realize the true interests of the two belligerents. An aircraft shot down or crashed meant thousands of jobs in the war industry, which had bailed the US out of the Great Depression.

This very practice is in full swing. The war industries produce, the merchants of death sell their products to "governments" of underdeveloped countries, and these make an excellent use of them (economically speaking, i.e. death and destruction) for the "developed" countries to solve the problem of industrial unemployment.

Then someone notices that those at the receiving end are hungry, and that they walk hundreds of kilometers in search of food, shelter, and instruction. Good-hearted do-gooders send thousands of tons of foodstuffs and essentials. "Developed" countries solve (partly of course) the problem of agricultural unemployment.

All of this is followed by "expert" personnel going to help *in situ*. Unemployment decreases accordingly.

It is evident that peace is the last things that such a setup wants. The real problem is usury, and for as long as this hidden enemy is not faced and defeated, there will be no programs, however backed by good will and put into practice by good people, that can turn things around.

All the so-called "industrialized" or "developed" countries have reached this stage. Whether they opt for using war materiel themselves, or for selling such stuff elsewhere, the immorality of the exercise should be obvious, but those who pocket "fat dividends" from the

[28] (1903-77). Follereau discovered that leprosy was curable, and cheaply. He has several foundations named after him.

industry are understandably unwilling to take a close look at what the toys of death do, especially if it is not their children who are involved. I will provide a single example: the child-soldier.

The 12-year old with his AK 47 across the shoulders is, in fact, "the most efficient fighting machine ever devised" in the opinion of a Sudanese military commander. Why?

- Recruiting is simplicity itself: he is kidnapped by a band of age mates at the orders of an adult soldier, and if he tries to resist or get away, his age mates cut him to pieces there and then, so as to dissuade others from imitating him;
- Training is equally simple: six months are more than enough for him to handle lethal weapons and to learn basic military tactics;
- Obedience is blind: still below the age of judgment, he doesn't think much of darting into the fray without thinking, or of committing the most revolting atrocities without blinking;
- The target he offers is minimal: he is difficult to spot and therefore to hit;
- If he falls dead, digging his grave requires minimum effort;
- Finding a replacement is equally simple: in the meantime a woman will have produced, suckled and brought up another one to take his place.

Chickens come home to roost if and when the 12-year old survives the ordeal, reaches the age of judgment, … and understands. Then there follow sleepless nights, desperate weeping, nightmares, and (rarely) suicide. In any case he will be a traumatized adult for life, irritable and antisocial. Many will remain in permanent exile: they dare not return to their native villages, where the survivors remember his atrocities.

But what does usury care? Thanks to him the shareholders of death will have pocketed their "fat dividends".

6. SOLUTIONS

Academe

One would expect, wouldn't one, that university faculties, tenured professors, prestigious textbooks, journals of great erudition, and thousands upon thousands of doctoral theses (published or not) not to speak of the Nobel Prize Committee, should notice the above predicaments, however cursorily.

But the academic world moves in another wavelength, driven by a false definition of economics and by various schools at loggerheads with reality first and with each other as a consequence.

The term "political economy," defined as "the study of production and distribution of wealth" has surreptitiously been replaced with the term "economics," defined as "the allocation of scarce resources."

This apparently innocuous definition hides not one but two traps. First: what is a "scarce" resource? Second, who is going to "allocate?"

There is no such thing as a scarce resource. Human ingenuity has always managed to find substitutes to anything made artificially scarce by human greed, which is what usually happens. Oil is a case in point. In 1850 whale oil, until then the chief product for domestic lighting, quadrupled in price, not because it was "scarce," but because its distributors had cornered the market and wanted to make a kill. By then someone had noticed that a black stuff oozing from the ground could be used as a substitute, and the modern oil industry took off, turning whale oil into a historical curiosity. But the story has not ended. Russian deep drilling, starting with

a 20 000m well in the Kola Peninsula in the 1960s, has proved that there is as much oil as one wants provided one is willing to drill very deep, and therefore expensively. With this technique Vietnam is now an oil producing country, which it was not supposed to be. Further, old oil wells thought to have been exhausted, have been observed to refill from the depths of the earth. This is of course unwelcome news for the giant oil corporations, but sooner or later, as J. K. Galbraith puts it, "conventional wisdom is put paid by the march of events."

The innuendo of the "allocation" is that only the "experts," those in the know, can "allocate." True, for as long as land and money monopoly stay as they are. When people wake up, as they are doing before our very eyes, the economy will take off as it should, i.e. on the two wings of Free Land and Free Money.

The Nobel Prize is a joke in its own right. Some recipients are awarded the prize not for what they know, but for what they can say. Joe Stiglitz, mentioned at the beginning, is a case in point. James L. Phelan, berating the WB/IMF, quotes:

> So what would Stiglitz recommend in place of the usual WB/IMF fare? He proposed radical land reform, an attack at the heart of 'landlordism', on the usurious rents charged by the propertied oligarchies worldwide, typically 50% of a tenant's crops. This is, alas, a more delicate subject. It's easier simply to have faith that constant economic growth will deliver us from the difficult issues of land tenure and access to income-bearing assets. This very political program is understandably not on the WB/IMF's list of chores, since as Stiglitz reminds us "if you challenge land ownership,

> that would be a change in the power of the elites". That's not high on their agenda.[29]

Not all Nobel winners are of the same mettle as Stiglitz. Some even believe in their theories. Robert Merton and Myron Scholes, the 1997 recipients, lost 1.25 trillion dollars in the Stock Exchange in 1998, applying the very calculations that had won them the Nobel Prize. The money had come from Central bankers believing in the magic "model", but who had to be bailed out by American taxpayer via the Fed.

Bernard Maris of the University of Paris lashed out:

> From Milton Friedman, the guru of the super-liberals, to Modigliani, they are the incompetents of the peremptory, repeaters of recipes they know to be wrong, major-domos of the powerful. They dare not say that there is no such thing as a theory of liberalism, of efficiency, of competition. It's all utopia, as totalitarian as Stalinism was.[30]

Tribal

Land belongs to the tribe communally. Money is unnecessary. "How can you buy or sell the sky, the warmth of the land? The idea is strange to us. If we do not own the freshness of the air and the sparkle of the water, how can you buy them?"[31]

[29] Personal note from Harry Pollard, Henry George School of LA, 28th November 2001.

[30] M. Blondet, *Open letter to the gurus of the economy who take us for imbeciles*, Avvenire, 18-4-2000.

[31] Attributed to Chief Seattle, Suquamish Tribe, 1854. Courtesy of Jeffrey Smith (geonomist@juno.com)

This view has one drawback: population growth eventually makes it impossible. If population growth happens, as it did in America, by massive foreign immigration, only violence can "solve" the problem, and only in bloodshed.

Population growth eventually imposes division of labor, and with it a monetary economy. Progress inevitably does away with the tribal setup.

Feudalism

Land belongs to the elite: nobles and the high clergy, who enjoy the *ius utendi.* They are prevented from exercising the *ius abutendi* by separating the two rights. The nobles shoulder the costs of defense and administration, and the church those of social welfare: worship, education, health, orphan homes, hostelry, etc., out of their rent.

The European feudal system lasted a good seven centuries. Its drawback was that it entailed serfdom. While not a slave, and lightly taxed, the tenant was nevertheless bound to the soil, enjoying virtually no freedom.

Feudal monetary policy was entirely dependent on the superstition that money must have "intrinsic value." The discovery that money could be managed, first by decreasing the gold content of the bracteates (1050-1350) and then by diluting it with copper in the Schilderlings (1400-1485) permitted a revival of trade, but hastened the demise of feudalism.[32]

[32] The bracteates were periodically recalled and re-issued with the same nominal value but lighter in weight. The Schinderlings were reissued with the same weight, but less gold content. In either case they were very successful attempts at increasing liquidity, and with it mobility. Feudalism's philosophy of a static society did not survive the attempt.

Capitalism: the title deed

With the end of the feudal system, the "sacrosanct" title deed guaranteed land tenure. Serfs became tenants, but the increasing demands for rent forced them off the land. Their only option was to move to the common lands where such existed, or to work for a pittance on the landlord's property. When the landlords enclosed the common lands, towards the end of the 18th century, the starving masses burgeoned around the cities, just in time for the Industrial Revolution to save them from starvation, but at what social cost we all know.

It was at that time when Adam Smith (1723-90) published *The Wealth of Nations*. Here is, in his own words, how he perceived the land question.

> As soon as the land of any country has all become private property, the landlords, like all other men, love to reap where they never sowed, and demand a rent even for its natural produce. The wood of the forest, the grass of the field, and all the natural fruits of the earth, which when land was in common, cost the labourer only the trouble of gathering them, come, even to him, to have an additional price fixed upon them. He must then pay for the licence to gather them; and he must give up to the landlord a portion of what his labour either collects or produces.[33]

Here is British pragmatism at its best. It works; therefore ask no further questions. Maybe it is not out of

[33] *The Wealth of Nations*, The Penguin English Library pp. 152-53.

place to mention that as Smith was writing his *magnum opus* he was enjoying a generous pension from (the rent of) the Scottish Duke of Buccleuch. It would have been impolitic to bite the hand that fed him. Never mind that the infamous Scottish clearances were taking place at the same time, with villages set on fire and people thrown out of their ancestral land to make room for sheep, which of course maximized the lairds' rent.

Modern economists of the liberal school do not repeat Smith's words. They do mention land at the beginning of the economics course as one of the factors of production. Then they say "abracadabra" and land transmogrifies into capital.[34]

The Social Question burst in all its virulence in the 19th century, forcing the workers towards new lands. The militarily strong British and Germans expropriated African tribes; the militarily weak Irish and Italians went to try their luck in the Americas. The real situation was described by Henry George in 1887:

> There are… three parties of production, and always a fourth and generally a fifth relating to distribution. In addition to A the employing capitalist, and B the employed labourer, there are C the landowner, D the tax collector and generally E, the representative of monopolies not that of land. What A and B can divide between them is not the product of their joint effort, but the product which C, D, and E leave to them.[35]

What George called "E the representative of monopolies not that of land" is in reality the power of

[34] Mason Gaffney and Fred Harrison, *The Corruption of Economics*, Shepheard Walwyn 1994.
[35] *The Standard*, 31st December 1887.

usury, better identified by Gesell a generation later. It is important to remark that capitalism intertwines the two monopolies of land and money more closely than any other economic system. High interest rates are indissolubly linked to land monopoly. When land, instead of being widely distributed, is grabbed by a powerful minority, land becomes the most profitable type of investment, with returns guaranteed by population and public infrastructure growing *around* the property. That is also why high finance is a declared enemy of agriculture. They see farming as a threat to their own activities, and rightly so. Food is a form of money. Subsistence agriculture and barter are two of the three factors (the other is bills of exchange) that prevent usury from raising its claims higher than it can. That is also why money manipulation has successfully driven millions of small farmers out of their land throughout the 20th century.[36] The title deed is not as innocuous as it sounds. Kenya, East Africa, still witnesses "tenant wars" with real bloodshed, and not only in the urban, but also in the rural areas for the 40 years since independence.

Agrarian Reform and Distributism

Land ownership is by nature aggregating; natural differences in ability and attitude always end up in the latifundium, i.e. the large estate cultivated by serfs at a subsistence wage. This is one of the reasons for the

[36] The relation between interest, cash, barter, bills of exchange and subsistence agriculture is fully spelled out in Gesell's *Natural Economic Order* Part 3. Interest cannot rise beyond the level at which people judge that it is not worth paying it and return to either barter or subsistence. In a monetary economy, bills of exchange cause goods and services to move without interest, but they are cumbersome and at times untrustworthy. An economic operator makes up his mind whether to pay interest or to adopt one of these solutions.

100% failure of agrarian reforms, wherever and whenever such have been carried out. Latin America abounds in examples, from Mexico to Argentina and Chile. That is also why Chesterton's[37] dream of a society where resources (especially land) are equitably distributed never took off.

Other reason for failure are that the redistributed land is always far away from the centers of consumption, which diverts wages into middlemen's pockets; farmers need seed and machinery, which force them into debt; hence it is a matter of time before their piece of land is once again aggregated to that of a big landowner.

Ecclesial

The pontifical social documents do not offer cast-iron solutions. They state principles that can serve as pointers for effective action. When they do, it is certain that the solution is free from doctrinal or moral, but not necessarily from economic or political, error.

Rerum Novarum (1891), citing St Thomas, makes the first point:

> Man should not consider his outward possessions as his own, but as common to all, so as to share them without difficulty when others are in need. Whence the Apostle says, command the rich of this world… to give with ease, to communicate.[38]

[37] 1874-1936. G.K. Chesterton was a journalist. Until his death he used the income from his books to subsidise his petty project: the journal *G.K. Weekly* where with Hilaire Belloc (1870-1953) he pushed the idea of a Distributist society. Both were aware of the inequalities of the modern economy.

[38] *Rerum Novarum* 24.

Private property, therefore, of land as much as of money, ought to fulfill a social function as well as cater for the owner's prosperity.

A second useful pointer can be read in *Quadragesimo Anno* (1931):

> It is an injustice, a grave evil and a disturbance of right order, for a larger and higher association to arrogate to itself functions that can be performed efficiently by smaller and lower societies… Let those in power… be convinced that the more faithfully this principle of subsidiary function be followed… the happier and more prosperous the condition of the commonwealth [will be].

Yet agrarian reform is what Pope Leo XIII recommended.

> If a workman's wages be sufficient… he will not find it difficult… to put by a little property… this …question cannot be solved except by assuming as a principle that private ownership must be held sacred and inviolable. The law, therefore, should favour ownership, and its policy should be to induce as many of the people as possible to become owners.[39]

But workmen's wages are insufficient not because of the greedy employer, but because of his acting as a broker of wages from workers to landlords and usurers. Leo XIII's assertion that "labour needs capital and capital labour," is true, but incapable of raising wages. Throughout the 20th century, wages have always risen at

[39] *Rerum Novarum*, 50.

the expense of other wages, never at that of rent or of interest.

This was paradoxically shown by Henry Ford (1869-1947), a non-Catholic. Free from debt, he quintupled the minimum wage and paid his workers salaries with which they could buy the cars they were producing.

Failure to solve the social question has opened the way for transnational corporations to dominate world economy with their policy of globalization.

Socialism

All land belongs to the State, and every citizen is a State employee. This solution is due to the facile Marxian assumption that the exploitation of labor is due to private ownership of the means of production. Socialists of all hues still believe that, oblivious to the resounding failure of the 70-year long Soviet experiment.

Land nationalization not only makes a serf of every citizen, but also renders money nearly useless. In Soviet Russia workers' salaries could not buy anything, and the only market that worked was the so-called "black" market.

Austrian School

The Austrian school abhors State intervention, but stands by the equation land = capital, under the spell of the abracadabra of the liberal school.

Everybody assumes, even the Austrian School, which is very vocal against it, that the issuing of money is a State duty and responsibility. Jörg Guido Hülsmann, of the von Mises institute writes:

> The production of money should best be left to the free market. Government interventionism does not improve monetary exchanges; it

> merely enriches a select few at the expense of all other money users. And on the aesthetic side, the disaster is of course complete: rather than deal with beautiful silver and gold coins, the citizens are compelled by law to hold unbecoming paper notes.[40]

Amazingly, even *The Economist* has taken to reviling paper money:

> Since [1971] the world has relied on "fiat money", so called because it is created by government fiat and is backed only by the promises of central bankers to protect the value of their currencies. It is the value of those promises that some are now questioning.[41]

Neither of the two pays attention to the problem of its hoarding, due to the intrinsic contradiction still operating since the days of Croesus. That they of the "unbecoming paper notes" and "beautiful silver and gold coins" should still pay no attention to either George or Gesell is mystifying to say the least.

Henry George's Free Land

Two things should be clear by now:

- There is no solving the social, or any other economic question, without tackling both land and money together.

[40] *Morality and Economic Law: Towards a Reconciliation. Mises Daily Article* 05th April 2004.
[41] *Heading for a fall, by fiat? The Economist* 28th February 2004 p. 82.

- Any solution must stand or fall by the principles of truth, justice, freedom, solidarity, and subsidiarity.

The principle of subsidiarity is not a general one. It is a particular case of the much more general Catholic ethical principle of *and-and*, which in ethical issues replaces the *either-or* characteristic of the other sciences.

Subsidiarity makes it possible for freedom and solidarity to *converge*. With the land question, what needs to converge is the institution of private property with the social function that *Rerum Novarum* recommends for it.

But transcendent principles of this nature are by no means easy to identify, for they are not amenable to logical induction. By logic one gets nowhere.

It must be admitted that the human mind, seeking truth by means of orderly thinking, gets disconcerted at this. It is no consolation to say that the logic of such solutions stands out most clearly *after* having identified and applied the transcendent principle, but *not before*.

That explains the clash, unnecessary but historical, between the doctrine of *Rerum Novarum* and that of Henry George.

The two doctrines were assumed to be contradictory, but no one checked that either of the two would have to be right and the other wrong and vice versa.

George proposed that bare land, regardless of development, be used as a tax base. The fruits of the landlord's labor would accrue to him 100%, whereas the rent of bare land, caused by the economic activities of the community *around it*, would go to the community as public revenue and infrastructures.

It can be seen that George's proposal is a good practical way of applying the principles of *Rerum*

Novarum. The two doctrines are therefore *sub-contraries*, i.e. both true.

The proof was the ease with which Archbishop Satolli re-instated excommunicated Fr Edward McGlynn in 1892.[42]

Satolli asked the priest to draft, as concisely as possible, the principles of Georgism to be examined by a panel of experts from which any personal friend of McGlynn had been excluded. The panel (Catholic University of America, Washington) unanimously agreed that Georgism contained nothing offending against faith or morals.

Next the panel asked McGlynn whether he accepted the doctrine of *Rerum Novarum*. The priest read the encyclical and unhesitatingly signed his agreement. Knowing his mettle, there is no doubt that he would not have signed had he objected even to a minor point.

Georgism was thus unofficially condemned and unofficially reinstated.

The above does not mean that George's so-called "single tax" is the only way to make private property absolve its social function. There are other ways. What counts is the principle: by shifting the tax basis from value *added* by human exertion to value *subtracted* from land, everything falls to its appointed place, i.e.:

- Truth: the State reasserts the sovereignty usurped by the institution of allodialism (freehold land);
- Justice: Industry is rewarded, laziness and parasitism prevented or punished;

[42] Dr Edward McGlynn (1837-1900) became an enthusiastic supporter of Henry George while the latter was away in Europe. When asked to withdraw his support from George' candidacy to the New York mayoral election of 1886, he was excommunicated.

- Freedom: all have now access to land if they so choose;
- Solidarity: the canon collected from occupancy defrays public expenditure (not necessarily 100% as George thought, but enough to abolish the most unjust forms of taxation);
- Subsidiarity: the institution of private property, indissolubly joined to its social function, can no longer be the cause of social disorder as in the past.

Silvio Gesell's Free Money

The money hoards mentioned here and there are not those of petty savers. Aside from today's financial bubble, Microsoft boasts a hoard of 56 *billion* dollars in cash, to survive, as they aver, a full year of zero sales. Lord Weinstock "had a pile of several billions of pounds in cash at the bank."[43]

If "several" means ± 7, he could have paid for the Channel Tunnel single-handed at the original estimate.

Such hoardings are fully legal, but as immoral as maliciously siphoning off oil from an engine to make it seize. Gesell, unlike Tobin, zeroed in on the hoards rather than on the transactions.

He proposed to tax liquidity at 5 to 6% annually, to force cash into circulation by preventing it from acting as a means of saving. At 6%, for instance, the Microsoft hoard would fetch the public coffers some $330 million a year.

His method was not only to separate gold from money, but also to separate the currency unit from the object representing it. With the unit at a constant purchasing power, the paper representing it would depreciate at a certain rate, expiring after one year from

[43] 1925-2002. Obituary, The Economist 27th July 2002.

the date of issue.[44] Validating stamps would keep its purchasing power during the time of circulation.

He staked his bet not on the quantity theory of money but on its velocity of circulation: a small amount changing hands repeatedly and fast would have the same effect as a large amount behaving like credit, i.e. changing hands once and then disappearing.

In 1932, in the thick of the Great Depression, practice confirmed theory. Mayor Unterguggenberger (1884-1936) of Wörgl (Austria) moved 2.5 million Austrian Schilling worth of goods and services with a paltry issue of 5 300 units of *Work Certificates*. Wörgl incurred the ire of the Austrian National Bank, which quashed the experiment after 14 months of proving to the whole world that the Depression could be beaten.

The necessary monetary reform would also meet the requirements of

- Truth: the contradiction built in the present form of money would disappear, as would the confusion between money and credit (M2…to M4);
- Justice: interest would slowly fall to 0%. Living off the work of others would no longer be possible;
- Freedom: every type of work, including housework, would be rewarded, thus giving women the choice to stay home or work outside;
- Solidarity: lending at 0% would be more profitable than hoarding at – 6%. Trust and friendship would necessarily increase;

[44] Gesell's proposed rate was 0.1% per month, or 5.2% per year. Other rates are possible. The important factor is that the rate chosen should be neither so low as to encourage hoarding, nor so high as to discourage acceptance.

- Subsidiarity: charity would supplement rather than replace justice as up to now.

As Victor Hugo (1802-85) remarked 150 years ago, "Nothing is more powerful than an idea whose time has come."

7. CONCLUSION

Metaphors don't prove anything, but help one understand. I like to compare the economy to a bird, which everyone, from "experts" to common folk, assumes to be flightless because nobody has ever seen it fly. And nobody ever saw it fly because in truth it never flew.

But it does not follow that our bird does not fly because it has no wings. Its wings are stuck to the body by captured land and double-faced money. Since a flightless bird is easier to control than a flying one, the vested interests that know the real nature of the bird have done everything possible to keep the existence of the wings concealed. By and large they have succeeded, and for millennia at that.

Ever since economics became a science (of sorts) its practitioners have concentrated not on the wings that they failed to see (or deliberately concealed, it's not up to me to judge), but on the bird's legs, beak, feathers and so forth. They have reinforced and streamlined all that gear, but it is obvious that without freeing the wings the bird will never fly, which is what it is supposed to do.

As Gesell says in the closing sentence of his magnum opus, "There is no economic problem that Free Land and Free Money cannot solve."

Translated into day-to-day economic terms, land grabbers and money hoarders have succeeded in living off the work of others by denying them the fruits of their labor. Attempting policies that leave in place the primary injustice have not succeeded, and never will. But there is a great disparity between the two questions.

The land question cannot be solved in the absence of political will. Landowners have always managed to influence political decisions, either directly by being themselves in power, or indirectly by lobbying for tariff and other policies that sustain their rents.

The good news is that money reform, unlike land, can start from the grassroots. The 20 000-plus communities round the world are proving this before our very eyes. The moment they agree on the same standard, usury will become a historical curiosity.[45]

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[45] Elsewhere I have suggested the school teaching period as monetary standard.

MOVING MONETARY REFORM TO THE "FRONT BURNER"[1]

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Abstract
Entering the 3rd Millennium we face both great danger and opportunity. Unheard of wealth concentrates into very few, largely undeserving hands. Even in America, the richest country on Earth, people work harder and produce more than ever, yet increasingly fall into debt and bankruptcy, while predators plunder society by merely shuffling papers. Major corporations concentrate on profiting by misusing the money system, rather than with production. Such corruption is not sustainable or justifiable. The American Monetary Institute holds that the structure of the money system itself is at the root of the corruption and we promote reform to bring our monetary system into harmony with the nature of money. There is a growing awareness of the urgent need for reform away from privately issued money toward more public control of money systems; away from a religious adherence to questionable economic theory, toward

[1] (This paper is drawn from speeches by Director Stephen Zarlenga to the U.S. Treasury in December, 2003, titled *The Lost Science of Money – A Solution to the States Fiscal Crises*; to monetary reformers at England's House of Lords in May 2004, titled *The Lost Science of Money & Monetary Justice: Using Publicly Created Money to Fund Public Projects*; and to the Bromsgrove Monetary Conference in October, 2004, titled *The War of Private vs. Public Control of Society's Money Power – The Order of Battle: Adam Smith vs. Aristotle.* These talks can be read in full at http://www.monetary.org All quotations are fully referenced in my book: Stephen Zarlenga, *The Lost Science of Money: The Mythology of Money – the Story of Power*, hereafter referred to as LSM.)

American Review of Political Economy, Vol 3(1), Pages 39-84
March 2005

producing desirable human results. There's a growing recognition of the need for better methodology – drawing conclusions in part from experience and historical cases rather than isolated theory. Our task: to make monetary reform a primary goal of 21st century justice movements. It may not be easy, but think how fortunate we are, in a sense, to face such a worthy challenge.

JEL CODES: N10

KEYWORDS: Monetary history theory and reform; Critique of economic method and Austrian economics; Monetary case studies; Monetary justice; Economic justice; methodology; mproving economic and monetary thinking methodology

1. The Lost Science of Money: A Solution to the States' Fiscal Crises

The fiscal problem has its roots in the structure and control of our monetary system and I intend to show how that structure *has ultimately been based on a false or inadequate concept of the nature of money. The Problem is that money has not been accurately defined.*

Perhaps the chief failure of economics is its inability, from Adam Smith to the present to define or discover a concept of money consistent with logic and history. Economists rarely define money, assuming an understanding of it. It's still being argued whether the nature of money is a concrete power, embodied in a commodity like gold; or whether it's a credit/debit issued by private banks. Does its value come from the material of which it's made? Or is it, as we have concluded, an abstract social power - an institution of the law, having value because its accepted in exchanges due to the sponsorship of government? The correct answer leads

to conclusions on the proper monetary role of government; whether the power to create and control money should be lodged, as at present in a somewhat ambiguous private issuer - the Federal Reserve System and its member banks - or should be wholly reconstituted within government. An accurate concept of money will light the way to solving the present fiscal crisis.

2. Money – The Human Struggle

A main arena of human struggle is over the monetary control of societies. It is exercised through obscure theories where corrupt interests have misdefined the nature of money to seize control of the money power, dominating society and deforming humanity in the process. *The money system is society's greatest dispenser of justice or injustice.* A good one functions fairly, helping create values for life. A bad, unjust one obstructs the creation of values; gives special privileges to some and disadvantage to others causing unfair concentrations of wealth and power; leading to social strife and eventually warfare and a thousand unforeseen bad consequences – physical *and* Spiritual.

As great power is exercised through money, power-hungry elements from ancient times to the present pursued the political ambition to dominate through the Money Power. Their main weapon has been the manipulation of language and thought, where definitions serve as heavy artillery. Those benefiting from the corruption see that "professionals" are financed to promote their viewpoint with economic "theories."

One reason economists have failed mankind so badly is their poor methodology – an over-reliance on theoretical reasoning. Alexander Del Mar the world's greatest monetary historian noted:

> As a rule economists...don't take the trouble to study the history of money; it is much easier to imagine it and to deduce the principles of this imaginary knowledge.[2]

This failure becomes staggering when combined with their reluctance to accurately define the terms of their theories.

This isn't new – in 1827 Malthus wrote a book to complain about poor *Definitions In Political Economy*, noting:

> It is quite astonishing that Political Economists of reputation should be inclined to resort to any kind of illustration however clumsy and inapplicable, rather than refer to money[3].

But then of the 60 "better" definitions, which Malthus presented, there was not a single one of money.

Aristotle's Science of Money

We can trace the money battle back to Aristotle's time and even then it was fought through control of language and media. He outlined a science of money still valid today:

> All goods must therefore be measured by some one thing...now this unit is in truth, demand, which holds all things together...but money has become by convention a sort of representative of demand; and this is why it has the name *nomisma* - because it exists not by nature, but by law or binding custom (which in Greek was *nomos*) and it is in our power to change it and make it useless (Aristotle, Ethics 1133).

[2] Del Mar, Alexander, *History of Monetary Systems* (New York: A.M. Kelley, 1978 [1895]).
[3] Malthus, Rev. Thomas, *Definitions in Political Economy*. London: J. Murray, 1827.

Aristotle identified money as an abstract legal power - a social invention. Its essence is not tangible wealth, but a power to obtain wealth – A crucial distinction. Plato agreed and advocated such fiat money for his *Republic*:

> The law enjoins that no private individual shall possess or hoard gold or silver bullion, but have money only fit for domestic use. ...wherefore our citizens should have a money current among themselves but not acceptable to the rest of mankind....(*Laws*). Then they will need a market place, and a *money-token* for purposes of exchange. (*Republic*).

Aristotle outlines the science and Plato's writings are in full agreement. Moreover, we find these key principles actually employed in both Greek and Roman Systems. Aristotle explained that money is not a commodity. And in clear demonstration of that principle, the Spartans purposely destroyed the commodity value of their iron money. He explained that society can legally create the money and can also make it useless. In clear demonstration Roman law set the value of their fiat copper money and Rome decried some money as useless during the Punic Wars, demonetizing the copper money held by towns wavering in allegiance.

Plato's *Republic* explained how commodity money was to be restricted to foreign trade, and a series of Rome's coins are examples of that.

Here are two ancient cases from Greece and Rome based on Aristotle's *Nomisma* concept of money.

Lycurgus' Spartan Pelanors

Plutarch describes an example of nomisma in his discussion of Lycurgus of Sparta's 8th century BC monetary reform, aimed at a society where wealth had become overly concentrated. Lycurgus banned using gold and silver and instituted iron slugs called Pelanors for Sparta's money system. Furthermore those iron pieces were dipped in vinegar while hot, to render them brittle and to destroy *purposely* any commodity value that they had as iron! They received their value through legal sanction. This system of iron nomisma lasted about 350 years and Sparta became a premier power. Plato confirms that Sparta's iron money was rendered useless with the vinegar treatment, and remarked that it was based on the "Dorian System" possibly indicating the existence of an earlier tradition.

3. Republican Rome Used A Similar System

Rome isolated herself monetarily, basing her money on copper. This "disenfranchised" the gold/silver hoards and therefore much of the power of the East. While gold could still be traded in Rome as *merchandise*; without the monetary power, the ability of the East to control or disrupt Rome's money would be reduced and she had a better chance to control her destiny. Republican Rome used Aristotelian nomisma, where bronze discs were valued far above their commodity values. Under this money, she grew powerful, staying independent from the East.

When the U.S. rose to become the dominant world power, we didn't have this advantage of monetary isolation. But during the two great crises of our nation – the Revolutionary War, and the Civil War - we erected money systems independent of Old World Power: the Continental Currency and the Greenbacks. And though both have been severely criticized, they served our nation well.

Rome won the Punic wars**,** but her money system was destroyed in the process and she regressed to the metals systems of the East. First to silver, and then with the imposition of Empire, Julius Caesar established a gold standard based on the weight system of the ancient temples. The growth of plutocracy accelerated; wealth concentrated in its hands and the population degenerated into slavery. Adopting the East's commodity money caused power and even the Empire's headquarters to shift eastward to Byzantium. Economists misinterpreted the move to silver and then gold, as progress, but it really signaled the breakdown of an advanced system. Today one often hears moralistic warnings about Roman inflation destroying the Empire, but on closer examination, it appears that deflation was a much greater problem. There were several great causes for this, which we can discuss in the question period if anyone asks. (Weight of Bezant was constant. 1. No mining; 2. Only Pontifex Maximus could mint gold coins; 3. Silver continually draining East; 4. False concept of money as commodity)

The breakdown of law and money continued to operate negatively, the one upon the other for centuries, in a slow downward spiral of societal decay, especially in the West, where the administration couldn't stop the city of Rome from being temporarily overrun. In this context the concept of money regressed back to crude metallism. Even commodity money nearly disappeared in the Western dark ages.

4. Medieval Europe

Charlemagne attempted to re-institute money in the West around 800 AD. But minting his pennies depended on working slaves to the death in his silver mines (LSM, Ch. 4). When Charlemagne's Empire ran out of conquests and slaves, the money system faltered. This plunder/conquest/slavery basis of precious metals systems continued well into the 19th century. Modern 19th and 20th century moneys, claiming to be precious metals systems, depended on an element of fraud, as we will see.

Europe's Money Systems became more functional only after the plunder of the Americas. The total loot taken at gunpoint from the Indians from 1500 to 1700, was over 1200 tons of gold and 60,000 tons of silver! These amounts far overshadowed European supplies, and prices rose about 400 to 500% during that time.

The theft was their minor offense. Estimates place the Indian population under Spanish control at 32 million souls and in less than 40 years they killed about 15 million of them; working most to the death in silver and gold mines. For example, at a mine near Mexico City one report states:

> "For half a league round the mine, and for a great part of the road to it, you could scarcely make a step except upon dead bodies or the bones of dead men. The birds of prey coming to feed on these corpses darkened the Sun."

Spain did the dirty work on the ground, while England and Holland formed companies - privateers - to raid the Spanish fleets intercepting much of the loot. This was a *very rare* period where the supply of new gold actually kept pace with population growth. Historically it hasn't done this, and so a gold money system has usually been a formula for deflation. As this "blood stained money" entered Europe it had profound effects, forcing great structural changes in economies, distributing wealth more broadly and creating a "Renaissance of the North."

Books appeared instructing farmers. Invention thrived. The Reformation is usually given the credit for the dynamic developments this influx of new money helped produce in northern Europe (see LSM p.216).

This inflow of metal was good in some ways and bad in others. Of course it was bad in that its source was murder and pillage of millions of Indians. On the other hand great voyages of discovery were undertaken in the quest to find alternate routes to China, for the expected "cheap" gold that was to be found there. (See LSM Ch. 3, on the gold/silver ratio dichotomy between East and West)

In Europe it held back monetary thought in crude metallism much longer than would have otherwise probably been the case. This focused large amounts of resources inneffectively. Even so, the principles of the science of money re-emerged from time to time as in England's 1601 Mixt Moneys case, or the writings in Bishop George Berkeley's *Querest* in 1735, who pointed out the nature of money was more in the form of a "ticket" than tangible wealth. Berkeley also challenged the idea of a privately owned central bank and promoted the view that it should be governmentally owned. Locke and Franklin also wrote wisely on money and considered money to be a pledge for wealth rather than wealth itself (see LSM, pp 316-320).

But then in 1776, Adam Smith's *Wealth of Nations* took a giant leap backward and formally obliterated any concept of money in the law by misdefining money as quoted below:

> By the money price of goods it is to be observed, I understand always, the quantity of

pure gold or silver for which they are sold, without any regard to denomination of the coin.[4]

The Battle Between Private Money and Government Money

Evidence of the fight over the money power is visible from Aristotle's time. His term for money –"nomisma" is seldom found in early Greek texts. It's in Herodotus in the 400s BC, but not again until Aristotle, over a hundred years later. We think the nomisma concept was suppressed in an ongoing struggle between the oligarchy - a kind of *private* "old Boy Network" - arrayed against *public* money, and the more democratic, public sphere of the Greek Polis, which introduced and controlled the new nomisma payment mechanism.

This *private vs. public* struggle has continued to this day:

- In Aristotle's Greece it was the Old Oligarchy vs. the Polis.
- In Rome it became the plutocracy versus Rome.
- In England it was the Goldsmiths vs. the Monarchy, representing society.
- Then it became the Bank of England Vs Society.

The Bank of England Had Usurped England's Money Power from the Crown in 1694, after Dutch William 3rd of Orange took over England. It signaled a recovery of the science of money, but it was organized privately for the power and profit of a small group instead of the whole nation. Recounting the stealth with which this "revolution

[4] Smith, Adam. *The Wealth of Nations*. Great Books (Encyclopedia. Britannica, University of Chicago Press, vol. 39, 1952 [1776], p.20).

bank," was formed, bank founder William Paterson remarked:

> The very name of a bank or corporation was avoided, though the notion of both was intended, the proposers thinking it prudent that a design of this nature should have as easy and insensible a beginning as possible…But it was found convenient to put it to hazard and expose so much of the nature of **the thing**…as was needful to have it espoused in Parliament.[5]

Until then England's monetary power was in the Monarch's hands. But from this point, bank of England credits – its notes and book credits – would be substituted in place of public money. This has promoted a confusion between credit, and money, to this day. But they are different things. Credit generally involves a promise to pay money but re*al money does not promise to pay something else. Money is the something else being paid.* Credit can legally be made into money, but it's not itself money. Money is on a higher order than Credit. It is unconditionally accepted as payment. "Credit expands when there is a tendency to speculation, and sharply contracts just when most needed to assure confidence…," wrote Henry George. Today economists are confusing the distinction between money and credit by referring to money as "high powered money" and referring to credit as "low powered money." But that is not the way to achieve more precise definitions in economics so sorely needed now. That mixes the concept of money with the features of credit and makes it easier for the issuers of credit to have their credits confused with a more suitable form of money.

[5] Quoted in LSM, Chapter 11.

Those behind the Bank of England obscured the real source of the Bank's power – *its legal privilege – its notes were accepted as money by government*. Using the principles of money for such private purposes produced harmful results: 120 years of near continuous warfare, spawning an unpayable national debt, leading to excessive taxation which led directly to horrors such as the Irish Potato Famine. Before then, when a nation's money system was used for taxation, the revenue generally aided the society at least in terms of what a Republic or King thought was needed. But private moneys like the Bank of England's concentrated society's resources into a few hands, crippling the possibility for government to function properly, leading to a growing contempt of government.

Today the battle is still the bankers versus the society**.** In philosophical shorthand it can be expressed as Adam Smith, or present day Economics vs. Aristotle. *At base, the battle remains Private Money vs. Public Money*. The outcome determines whether the money system operates to serve the *few in control*, or the *whole society*.

What determines the outcome of the struggle?

It is determined by society's concept of money – its definition of money. I'll give a case study from American history shortly. Who controls the language will control the monetary power will control the society will influence the language, etc. Mankind can live under various forms of government from dictatorship to republic, but the best systems are those in harmony with human nature. Likewise many things can be made into money, but the best will be the ones in harmony with the nature of money. Remember: don't confuse money with tangible wealth. Yes, commodities can be improperly monetized by law, as when the U.S. was officially on a gold standard and the currency was exchangeable for gold coin. The result made the money system hostage to the commodities situation; hostage to the people, companies, countries that control the commodity. Ultimately it removed the monetary power from society and placed it into the hands of the wealthy.

And don't confuse money with credit – either private or public credit. Yes, private credits can be improperly monetized by law as in the United States, where bank credits are given special legal privilege through law, and are accepted by government for taxes and made legal tender also. But that gives great privilege to those whose credits have been monetized, to the detriment of the whole society. The money system then becomes an engine of injustice – as it is now.

Accountants have confused this by calling different things by the same name. When money is placed into an account, it can be recorded as a credit there, but that does not make the nature of money a credit. Monetizing private credit removes the monetary power from society and places it into the hands of the bankers. I ask you to make an effort to separate these concepts in your mind, and see where it leads you.

Today there is an effort to remove the concept of money entirely from our language and replace it with a concept of credit. That would make real monetary reform not only impossible but literally "unthinkable" because if the concepts necessary to think about money will no longer exist, then when people believe they are thinking about the concept "money" they will really be working with the concept "credit" in their minds.

Adam Smith vs. Aristotle

Adam Smith helped erect a Mythology of Money that has obscured the science of money. History and thought shows moneys essence to be an abstract legal power, but economists still argue whether it should be a commodity like gold; or a private credit issued by banks. *Economics has never properly defined money!* The "father of economics" himself - Adam Smith – promoted this confusion by attacking the legal concept of money in his definition:

> By the money price of goods it is to be observed, I understand always, the quantity of pure gold or silver for which they are sold, without any regard to denomination of the coin (see footnote 3).

Smith's primitive misdefinition of money as a commodity insinuated a mythology of money into economics in 1776, from which it has never recovered. He did this despite the work of Berkeley, Locke and Franklin, from 1729 to 1735, which more accurately identified money's abstract nature**.**

The Bank of England had advanced to abstract money; not in theory, but in practice. Their abstract notes and book credits became used as money, but *in theory* they insisted it was convertible to gold and silver. Smith regressed in theory from unlimited coinage (moneta) to ponderata – metal by weight – where the concept of money had been before the Romans arrived. His theory applied to their practice caused confusion and created mystery to this day. Interestingly, Marx did little better.

A priesthood of economists was recruited, trained and rewarded to promote the myths; ignoring the evidence to the contrary; disregarding its bad effects on the people. Thus the great 19th century English reformer Thomas Michael Sadler observed: "Economists are the Pests of Society and the persecutors of the poor."

The American Money Struggles Contain Many Of The Best "Case Studies" for understanding money. We

have been a great monetary laboratory - every conceivable solution was tried at some time, and we've been a paper money nation from Colonial days. Our development was inseparable from it - without it there'd be no United States. English and Dutch laws forbade sending coinage to the colonies, placing them in continual distress. The intent was to extract raw materials, not for the colonists to trade with each other. An early form of globalization. The Colonies had to devise monetary innovations. *(LSM, Ch. 14 & 15)*. In the country pay period (1632 – 92) 17 different commodities were monetized by law at specified prices. It didn't work - everyone wanted to pay with the least desirable commodity, in the worst condition.

1633 - Virginia and Maryland monetized tobacco, issuing warehouse receipts for it. A bumper crop in 1639 meant that half the crop was burned and debts had to be reduced by 60%.

1652 – Hull's mint in Massachusetts stamped the gold and silver "tree coinage." But it quickly flowed to England and was melted down.

Private land banks were set up but were shunned by the colonists, who considered money a prerogative of government, as it was in England until 1694.

Then in 1690, 4 years before the Bank of England, Massachusetts embarked on a radical course and issued paper bills of credit, spending them into circulation. Rather than a promise to pay anything, they were a promise to receive them back for all payments to the commonwealth. The colony thrived. Other colonies copied them and *infrastructure* arose.

In 1723 Pennsylvania's system loaned the bills into circulation, charging interest on them and using it to pay colonial expenses. Ben Franklin wrote:

> Experience, more prevalent than all the logic in the World, has fully convinced us all, that paper money has been, and is now of the greatest advantages to the country.[6]

In Franklin's words, one detects a tension even then, between theoretical argument and practical experience, a continuing battleground in economics today.

Some long lost principles of the Science of Money quickly resurfaced:

* Money need not have intrinsic value; its nature is more of an abstract legal power than a commodity.

* Accepting the government paper back in taxes was the key feature needed to give it circulating value.

* The quantity of money in circulation had to be regulated to maintain its value.

* They observed that paper money helped build real infrastructure.

***** *Most importantly, the colonies did not issue more money than their legislatures authorized. They have an outstanding record issuing currency.*

Of over a hundred colonial issues I found only one case of fraud. In Virginia, a Mr. Robertson who was supposed to be burning the old notes as new ones were printed, was giving them to friends instead.

But in the battle for monetary dominance the colonial monetary experience has been miscast as irresponsible inflation money. This was the result of 18th century Boston's medical Dr. William Douglas' inaccurate

[6] Franklin, Benjamin. *Modest Inquiry into the Nature and Necessity of a Paper Currency*. In Benjamin Franklin, *Writings* (New York: Library of America, 1987).

writings. The error was corrected by Alexander Del Mar in 1900 in *The History of Money in America*[7] but was ignored. It was authoritatively cleared up again by Professor Leslie Brock in 1976 in *The Currency of the American Colonies*[8]**,** and was again ignored. Many economists, especially the Austrians and Libertarians still haven't got the message that colonial government paper money was crucial in building the nation.

In 1764, England's Lords of Trade and Plantations prohibited all colonial legal tender issues, and that became the underlying cause of the American Revolution, not some tax on tea.

The Continental Currency became the lifeblood of the revolution. $200 million were authorized and $200 million issued. The Currency functioned well. In late 1776 the notes were only at a 5% discount against coinage, when General Howe took over New York City and made it a center for British counterfeiting. The British counterfeited billions; newspaper ads openly offered the forgeries; yet English General Clinton complained to Lord George Germaine:

> The experiments suggested by your Lordships have been tried, no assistance that could be drawn from the power of gold or the arts of counterfeiting have been left untried; but still the currency ... has not failed.[9]

In March 1778 after 3 years of war, it was at $2.01 Continental for $1 of coinage. The Continentals carried

[7] *History of Money in America*. c. 1900. Repr., NY: Burt Franklin, 1968.
[8] Brock, Leslie V. *The Currency of the American Colonies 1700-1764* (New York: Arno Press, 1975.
[9] Schuckers, J.W. *Finances and Paper Money of the Revolutionary War* (Philadelphia: John Campbell, 1874).

us over 5½ years of Revolution to within 6 months of its final victory. Thomas Paine wrote: “Every stone in the Bridge, that has carried us over, seems to have a claim upon our esteem. But this was a corner stone, and its usefulness cannot be forgotten.[10] Our Constitutional Convention considered two grand themes of humanity. First whether mankind could be self-governing or had to be ruled by authority, often referred to as the American experiment. We are still learning the outcome, and one of the reasons it’s still in doubt is because of the way the Convention mishandled the other grand theme – and that is, the nature money. By the time of the Convention, the great benefits of the Continentals was nearly ignored; along with much of the rest of our hard won monetary experiences. Some wanted to emphasize that the Continentals became worthless and rejected the idea of paper money altogether. They ignored that paper money was crucial in giving us a nation; that abstract money requires an advanced legal system in place; that the normal method of assuring its acceptability is to allow the taxes to be paid in it. Then there was the matter of a *war* against the world’s strongest power. Tom Paine said it best:

> ...But to suppose as some did, that, at the end of the war, (Continental Currency) was to grow into gold or silver, or become equal thereto, was to suppose that we were to get 200 millions of dollars by going to war, instead of paying the cost of carrying it on.[11]

The convention met from May to September 1787 but the money subject didn’t come up until August 16. Remember, Jefferson and Paine were not there. Franklin

[10] See LSM, Chapter 14.
[11] Quoted in LSM, Chapter 14.

was too old to speak.A curious book on money appeared just then, written anonymously by Calvinist Minister John Witherspoon, – the only clergyman signer of the declaration of Independence. The book attacked Government money and promoted Adam Smith’s view that only gold and silver are money. He stonewalled our hard won colonial monetary experience. The power for government to properly create money, long considered as a necessary part of sovereignty, was contained in 5 magic words – to emit bills of credit. This provision was already in the articles of Confederation, but the Federalists - the merchant/commercial interest, largely responsible for calling the Constitutional Convention in order to strengthen the national government, fought to exclude this monetary power, from the new government, arguing that it could not be trusted with it! Some of them intended to get hold of the power privately as had been done in England.

The Supreme Importance of the Concept of Money Now Becomes Evident: For if money is primarily a commodity, convenient for making trades, which obtains its value out of “intrinsic” qualities, then it could be viewed more as a creature of merchants and bankers than of governments. But if the true nature of money is an abstract social institution embodied in law – obtaining its value largely through legal sanctions, then it is more a creature of governments, and the Constitution had better deal with it adequately. Describing how a uniform currency is to be provided, controlled and kept reasonably stable, in a just manner. It was on this crucial question that the Constitutional Convention faltered. The delegates accepted Adam Smith’s primitive commodity definition of money as gold and silver and didn’t firmly place the monetary power into government, leaving it ambiguous. Later they’d argue over what they had done. But the power would still exist, since it is as important as the legislative, judicial and executive powers.

I am suggesting that the nature of human affairs requires government to have four branches, not three; the fourth branch to embody and administer the monetary power.

The Constitution trusted the people with the political power; but didn't firmly place the monetary power in their government. This (along with slavery) is the Original Sin of American Politics! As a result the power was left up for grabs. Alexander Hamilton wasted no time in "grabbing."

Martin Van Buren, 8th US President, wrote a great book on the Convention – *The Origin of Political Parties in the US.*[12] He spent time with Jefferson in Virginia and was given information and documents to pass on to posterity after his death. Much of the following is based on Van Buren's recounting of these in his book.

5. How Private Central Banking Started in America in Three Steps

The first step was not to define precisely the governments' monetary powers at the Constitutional Convention – leaving it ambiguous, as we have described above. The Second Step was the bond theft: The Constitution went into effect in late 1789. Van Buren described Hamilton's first move as Secretary of the Treasury, in 1790: "Hamilton assumed some $15 million of the state debts...an act...neither asked nor desired by the states, unconstitutional and inexpedient…" What was so bad about it?

"A large proportion of the domestic debt (was held by) the soldiers who fought our battles, and the farmers, manufacturers and merchants who furnished supplies for their support....When it became known to

[12] Van Buren, Martin. *Inquiry into the Origin of Political Parties in the U.S* (New York: Hurd & Houghton, 1867).

members of Congress, which sat behind closed doors, that the bill would pass...every part of the country was overrun by speculators, by horse, and boat, buying up large portions of the certificates for (pennies on the dollar).[13]

Madison, saw what was happening and tried to stop this unfair grab for money and attempted to have the law pay speculators less than the original holders, but he was voted down.

The Third Step**:** Hamilton and associates, having kept the monetary power out of government hands, moved to assume it themselves. The Bank of North America was the only bank in the US, formed in Pennsylvania on Tom Paine's initiative to assist the revolution. Arguing that it was only a state bank, Hamilton suggested it come forward if it wanted to alter itself for the national purpose. Curiously, the Bank took no steps toward this obvious increase in profit and power.

Hamiltons' Federalists quickly put through legislation to charter the First Bank of The United States, as a privately owned central bank on the Bank of England model. The Bank would be issuing paper notes not really backed by metal, but pretending to be redeemable in coinage, on the one condition that not a lot of people asked for redemption! They really did not have the coinage. The bank would do what they had blocked the government from doing! Print paper money.

Because Hamilton himself was not a swindler (he was married to one of the richest women in the U.S. from the Van Renselauer family of Kinderhook a few miles from our headquarters, and close to Albany) his actions have received less criticism than they might otherwise have. But Jefferson through Van Buren

[13] LSM, Chapter 15.

presents a convincing case that Hamilton's party – the Federalists – was totally corrupt, and that Hamilton himself believed in and fostered or at least allowed such corruption with the idea that corruption was necessary to "grease the wheels" of his system. The Federalists, as Van Buren discusses, were not acting on behalf of England, but were trying to set up and grab for themselves, the same instruments of privilege that existed in England, such as the Bank of England, England's private central bank.

Thus the real question in practice was whether it would be private banks or the government that would create paper money. Will the immense power and profit of issuing currency go to the benefit of the whole nation, or to the private bankers? That's always been the real monetary question in this country.

While gold and silver served as a smoke screen what the bankers really counted on, were the legal considerations of the money. They knew that all that was needed to give their paper-notes value, was for the government to accept them in payment for taxes. That, and not issuing too excessive a quantity of them. Under those conditions, the paper notes they printed out of thin air, would be a claim on any wealth existing in the society. And we see why the Bank of North America was not put forward for this purpose: the U.S. Government had owned 60% of it. Thomas Willing resigned the Presidency of the Bank of North America, to become President of the first Bank of The United States. Hamilton, in the bank legislation had specified that the U.S. government was to own only 20% of the new Bank.

Where did the money for 1st Bank of the U.S. come from? The $10 million share subscription for the banks' shares, was oversubscribed within 2 hours. Less than 1/10 of it was ever paid in gold. The rest of the payment was accepted in the form of bonds – *the very government bonds that Hamilton had turned from pennies on the dollar to full value.* That is, when earlier, Hamilton's move to raise the value of the old colonies bonds from near zero to full value, to be paid for by the U.S. government; now these same bonds were being used by the private speculators who had bought them immorally, to pay for their shares in the 1st Bank of the U.S.

So you see where the money for the private bank actually came from – from the American people. Even if the bank had "faithfully" stuck to gold and silver, the nation's monetary power would still have been alienated to the east - to the European holders of those commodities, since they held the gold and silver. Same people we'd just fought the revolution against! Thanks to Jefferson's efforts, the bank was liquidated in 1811. Three quarters of it was found to be owned by Europeans – English and Dutch.

The 2nd Bank of the U.S operated illegally from inception, accepting IOU's instead of the required gold in payment for its shares. So again the banker's gold "requirement" turned out to be a masquerade. This private central bank immediately embarked on a wild monetary expansion. Beginning operations in April 1817, by July it had 19 branch offices and had created $52 million in loans on its books and an additional 9 million in circulating currency, based on gold and silver coin reserves of only $2.5 million. This tremendous expansion caused a wild speculative boom. Then in August 1818, the bank turned abruptly and began an insane contraction, causing the panic of 1819. It cut its outstanding loans and advances from a high of $52 million, down to $12 million in I819. Its circulating notes dropped from $10 million to $3.5 million in 1820. A massive wave of bankruptcies swept the nation.

The subsequent history of this bank and its fight to the death with President Jackson reads like a financial soap opera. It fought viciously against President Jackson who then removed all government funds from it. Eventually it was destroyed in a cotton trading scandal and the Banks president was indicted but not convicted for losing shareholders funds. The story of various state-chartered banks is similar.

Meanwhile the U. S. treasury acted responsibly: in the aftermath of liquidation of the first and second Banks. With the bankers temporarily defeated, US Treasury notes were responsibly substituted in place of banknotes. The treasury issued them and spent them into circulation for government expenses. About $65 million were authorized and only $37 million actually issued. Initially they were all large denomination, paid interest; were redeemable in gold and required formalities to transfer. By 1815 they became bearer certificates with no redemption date; paid no interest and were in smaller denominations. Thus they were nearly a true money form. The fact is that the US government has always acted responsibly in creating money. Not so the private banks!

6. Private Versus Public Control of Money

A Science of Money shows that issuing money belongs in the hands of the nation to be used for the common good. A Plutocracy counters with a mythology: the slur that government, the organized expression of our society, can't handle it. Centuries of propaganda raise the fear of inflation and abuse under government money, even though the record shows much greater monetary abuse by private systems. In this campaign they still advertise the 700-year-old cases of monarchs "debasing" their coinage, but *never* give the context that this period occurred after the collapse of European monetary order with the fall of Byzantium in 1204. Not mentioned is that much of the kingly alterations were a necessary form of taxation, or that Republics fared much better than monarchies, or that private bankers caused greater problems.

As an island community **England**'s Kings did pretty well on money.

In 1346 Parliament tried to gain control over money but was refused. In 1414 Parliament tried to get veto power on money but was again refused. Breckenridge thought parliament failed because the English King's long standing monetary prerogative had been used responsibly. Shaw's History of Currency, written in 1896[14], could identify only one case of monarchical coinage irresponsibility: "This instance of debasement (1545-46 under Henry VIII) is the only one on record in English currency history," he wrote, and it amounted to a grand debasement of about 15%!

Fifteen percent? What is the big deal? If your mental impression of that case is a lot worse, it shows how effective the propaganda is. The distinguished conservative journalist Henry Hazlitt epitomized this modern day reigning error on money in his introduction to Andrew Dickson White's essay, Fiat Money Inflation in France, a classic attack on government: "(The) world has failed to learn the lesson of the Assignats. Perhaps the study of the other great inflations - of John Law's experiments with credit in France;…of the history of our own Continental currency …; of the Greenbacks of our Civil War; of the great German inflation that culminated in 1923 - would help to underscore and impress that lesson. Must we, from this appalling and repeated record, draw once more the despairing conclusion that the only thing man learns from history is that man learns nothing from history?"[15] Hazlitt really believed history

[14] Shaw, W. A. *The History of Currency,1252-1896* (Putnams: New York: A.M. Kelley, 1967 [1896]).
[15] White, Andrew Dickson*. Fiat Money Inflation in France* (New York: Foundation For Economic Education, 1959, Introduction).

backed up his viewpoint, but it doesn't, when one bothers to look.

Let us take a look. First, let us turn to the Continental Currency of the American Revolution. We have already mentioned that $200 million were authorized and $200 million issued; that they functioned well until Britain counterfeited billions of them! If you ever find out how many, please let us know for the record. Newspaper ads openly offered the forgeries. Even so the Continentals carried Americans to within 6 months of final victory and gave us a nation.

France's Money System was brought down by John Law a fugitive Scottish gambler. But Law's operations were structured as private companies despite his recommending governmental structures. After an initial widely hailed success in 1720, his main focus became raising the price of the private company shares. Law's system was thus largely a failure of private money speculation. Thus it is not correct to blame this incident on government money. Law really was a person of substantial intellect and monetary understanding, as evidenced in his initial 1720 success in alleviating France's monetary problems: he thought he could make a fortune, while helping France at the same time. From a harsher, more polemical viewpoint the obvious lesson here is that it is not a good idea to turn your nation's money system over to a professional gambler wanted for murder in his home country.

In France, government-issued paper, the so-called Assignats, were distributed since 1789, but in a society already ruined by aristocratic extravagance and revolution. In the money battle White's short book *Fiat Money Inflation in France* is a major propaganda weapon against government money and is direct evidence of how the battle is fought. But the book was written in 1876 during the Greenback battles, 100 years after the Assignats, in order to block the Greenbacks.

Stephen Dillaye writes us that White, whose inherited fortune arose from banking, neglected to mention among other things, that Britain counterfeited far more Assignats than the French ever created. This was documented in English court cases where the counterfeiters sued each other! White's book has somehow been continuously kept in print by conservative foundations, the latest being the Cato Institute; Dillaye's important essay, out of print for 125 years is quite rare but we managed to find one, and will reprint it.

Well, surely **Germany**'s 1923 hyperinflation condemns government money!

No, actually that occurred under a privately owned and privately controlled central Reichsbank. The underlying dynamics of this extraordinary phenomenon were complex, and intimately determined by the political (foreign) reshaping of Germany after her defeat in WWI; the triggers of this monetary explosion were in fact connected to the financial legacy of the war's financing and the devilries of the Allied policy of reparations, a discussion of which would lead us too far afield. At any rate, it may of interest noticed that the hyperinflation (50 percent price increases per month) accelerated when the May 26, 1922 law was put into effect, removing all governmental influence on the Reichsbank and placing it entirely into private hands at the insistence of the occupation forces. This period marked the beginning of the runaway depreciation of the currency, which would unleash a year and half later the wholesale flood of the Mark into nothingness. The Reichsbank Governor that came after the flood, Hjalmar Schacht, reminisced that in July 1922 it was 300 marks to one dollar; in November 1922 it was 9,000 to one; in January 1923 it was 49,000 marks to one dollar; in July 1923 it was 1.1 million marks to one dollar. Eventually it was stabilized on November 20, 1923 at 4.2 trillion Marks to one dollar.[16]

Do you see the pattern that emerges from these monetary fiascos? Do you see that the Austrian School is not relating the real facts on these cases?

The American Greenbacks. Liberal catechism has always told us through it textbooks that the Greenbacks were nothing but the fruit of fraudulent politics, worthless inflation money. The Brits sent over "experts" to attack the Greenbacks. Like Walter Bagehot and the former mental patient Bonamy Price (who was given Thorold Roger's professorship at Oxford, after Rogers was booted out for statistically proving that Englishmen were in a dreadful declining economic condition for over 300 years).[17] Bagehot condemned the Greenbacks and the United States: "So far from its being an economic act which governments do for the benefit of their subjects it has been a political act which they have done for their own sake." [18]

This anthropomorphic view of government - pretending the government has desires and attributes like a person, is an essential element of the financiers' attack of their main potential opponent - our government. While this anthropomorphism is nonsense, it serves to smear government as being "motivated" to abuse the monetary system, *the way for example that private bankers are.*

But again, on examination of the facts, the case against the Greenbacks doesn't stand scrutiny. There were $450 million authorized and $450 million were printed. Counterfeiters couldn't duplicate the

[16] Schacht, Hjalmar. *Stabilization of the Mark* (London: George Allen & Unwin, 1927), and *The Magic of Money*. (transl. P. Erskine) (London: Oldbourne, 1967).
[17] See LSM, pp 490-91.
[18] See LSM, Ch.17.

Greenbacks. Every Greenback was eventually exchangeable (unnecessarily) one for one with gold coin. The Greenbacks were our best money system to date.

But Greenbacks were not promises to pay money later – they were the money. Since they were not borrowed, they did not give rise to interest payments and did not add to any national debt. The U.S. Treasury printed them and spent them into circulation. Neither should they be called "public credit" a near meaningless term when used to describe money. For the government is not really a debtor to the holder of such money, except in the guarantee to accept the money back in taxes. That is not a normal creditor/debtor relationship implied by the term "public credit." Knowledgeable reformers – Congressman Benjamin Franklin Butler – apparently aware of this conceptual problem referred to them as "certificates of value" – *money* is the better term!

Senator Howe wrote:

> The Government may be able to borrow from the banks, but the Government cannot borrow coinage of the banks…but (only) their promises to pay money. ...We must rely mainly upon a paper circulation; and … that the paper, whoever issues it, must be irredeemable. All paper currencies have been and ever will be irredeemable. It is a pleasant fiction to call them redeemable…I would not expose that fiction only that the great emergency which is upon us seems to me to render it more than usually proper that the nation should begin to speak the truth to itself; to have done with shams, and to deal with realities. [19]

[19] Ibid.

To have done with shams and deal with realities – sometimes that requires a crisis, to activate us. And what if instead of being spent on destruction, the Greenbacks had gone into building infrastructure, and canals and roads? Spending such money on infrastructure need not be inflationary. The great lesson of the greenbacks is that in times of crisis - *and other times too* - our nation has Power to do what's financially necessary. We don't have to beg or borrow from the wealthy and create an astronomical national debt; or tax the middle class into oblivion, or cancel necessary programs. We can use the nations' sovereign money power far more than we presently have been allowed to realize.

The struggle between private versus public control of money continued through the rest of the 19th century. The Greenbacks continued to constitute about a third of our money supply. Generally the private money power dominated. But in periods when the government exercised control an excellent record was established – *superior to that of private control.* The bankers continued their pretense that gold was the essential nature of money, and even the Federal Reserve in 1913, appeared to be gold-based. But immediately upon inception, we were pushed into warfare and within 20 years Americas' farms, cities, exchanges and money system were all wrecked, ending in the great depression. It was again left to our government to rescue the nation. It's forgotten today, but the Thomas Amendment passed with legislation in 1933, gave the President the power to create $3 billion in new Greenbacks, if the banking system didn't co-operate.

7. The American Money Scene Today: Reform Proposals and Ideas

It must be stressed that many monetary reformers in America are not aware of the nature and history of money and monetary battles, summarized above and fully described in my book, *The Lost Science of Money*, from which this historical excursus is drawn. Bombarded by plutocratic propaganda for centuries these reformers don't realize that government or publicly issued money actually has a superior record compared to privately issued money. As a result, some of their reform proposals move backward to already tried and failed systems rather than forward toward true progress. *But all those who devote their energies to improving our system are strongly commended*; and at the same time are urged to make sure they are not serving to entrench the monetary miscreants. Let us take a brief overview of four groupings advocating reform.

8. A Gold Standard Reform

This type of proposal demands, as in the past, that money be backed by gold or other ('scarce', naturally) commodities. The supporting faction is composed largely of people involved in gold mining or coin investments, conservatives, and some fundamentalist religious folk, in an unlikely alliance with more atheistic Austrian-Libertarian elements. Those who are investment oriented miss the point that whatever makes gold interesting as an investment, makes it unsuitable as money. The 'goldbugs', as they are often labeled, have failed to comprehend the abstract nature of money. Succumbing to centuries of propaganda, they are confusing money with wealth. But history shows that the so-called gold standard has been a shell game and a ruse. Over and again it has been a method of concentrating special monetary privileges into the hands of a banking plutocracy. The misinformation being spread today that it helps the common man because it stops inflation, is wrong. First as pointed out in LSM it does not always stop serious inflation.

Second, labor has suffered far more from deflation or restriction of the money supply than from inflation, and a metallic based monetary system has generally been a formula for deflation. Under deflation, it's not labor, but those with money or to whom money is owed, who automatically benefit without giving anything in return. Those in debt are harmed because they must repay it in more valuable money. As the industrialist producers in a society are often large debtors; industry is thus harmed and this harm is passed through very quickly against labor.

Experience shows this tends to happen under a gold standard because gold production has almost never kept pace with population growth, let alone industrial and commercial needs except briefly from 1500-1650 when gold and silver were being plundered at gunpoint by the fleet load from the Americas.

Some Austrians argue that one need only change (raise) the value of gold and any amount of gold can then be the base of the worlds money systems. But that ignores that those in debt will be unfairly harmed by such rises in the value of money. There seems to be an unspoken assumption that debtors are freeloaders deserving of such punishment.

Thus the usual way to avoid deflation with a gold standard, is by not really having a gold standard and creating leveraged amounts of paper money credits, or book credits based on smaller amounts of gold; making the promise of convertibility a fraud, instituting special privileges for bankers and subjecting the monetary system to panics and crashes. One of the things we learned from the Great Depression is not to do that

again. And remember, to advocate that money must be a commodity or backed by a commodity is to destroy the distinction between money and wealth. The very concept of money, and its societal basis in law is undermined. The control of such a money system remains in the hands of those with the wealth - by definition, the plutocracy.

The Austrians/Libertarians must exercise more care and go beyond a commitment to ideology and theory; to consider that the real world effects of those views do not usually turn out as advertised. They have mostly aligned themselves with the gold faction or with Hayek's free banking notions (see below).

It should be mentioned that there is an observable geopolitical move presently afoot, promoted in part by western elements, to mislead the Islamic world into gold-based money, and some Moslems are taking the bait. This supports the present moves promoting centuries of future warfare with the Moslems. It is happening despite the fact that the Prophet Mohamed expressly told his followers to honor fiat money.[20]

9. A "Free-Banking Monetary" Reform

The present day call for free banking is among the least informed and most arrogant of monetary reforms yet put forward in our nation. It seems that to promote an idea without real examination today all one has to do is put the word "free" into its name. The term "free banking" is vague, because its supporters have not uniformly defined it. We take it to mean a system where bankers are allowed to create the money supply in the form of their credits, or notes, which are allowed to circulate without restriction or regulation, to the extent that the

[20] See pages 623-627 in LSM.

markets will allow. But isn't it really up to these advocates to define their own terms?

The strident anti-government attitude of many of those promoting free banking has created a prejudice in them to view all regulation as bad and, contrary to the lessons of history, to place their trust in the bankers to act honorably! But to promote free banking requires that one dismiss the universal historical condemnations of it by expert observers such as Gouge, Knox, Raguet, Bullock and Sumner, to name a few. The 19th century reformer Henry George observed that: "The evils entailed by wildcat banking in the United States are too well remembered to need reference… and no-one would now go back to them."

Now 150 years later along come the free bankers who assure us that he and the other observers were wrong. Why? Because their theory tells them so! This modern "free banking" movement was spawned by Hayek's essay titled *Denationalization of Money,*[21] which was mainly an attempt to throw a monkey wrench into the early plans for the Euro, and is really an affront to serious monetary thought. Here are some of the problems with the free bankers "arguments":

1) They have misread history as is clear from their mislabeling the American "free banking" period as 1836 to 1864, when it was mainly pre-1836. They make this huge mistake because the New York law in 1836 that imposed much greater legal restrictions on banking, was called a "Free Banking Law." Naturally the post 1836 period gives better banking results, but anyone can see that its a period of greatly increased government regulation, which required real reserves, better

[21] Hayek, F. *A. Denationalisation of Money*, *The Argument Refined* (London: Institute of Economic Affairs, 1978).

supervision; double liability for bank shareholders; diversification of loans, etc.

2) They have disregarded as "anecdotal," the universal condemnations of free banking by expert witnesses. One can't ignore these indictments from highly qualified observers from across the political spectrum. For example John Jay Knox, Controller of the Currency and generally friendly to banker interests wrote in the official 1876 Treasury report: "The history of banking in the various states before the (civil) war will make plain to anyone that the note issuing privilege was much abused to the great detriment of individuals and the public. Banks were started for the sole purpose of foisting worthless notes upon a trusting public….The idea that the government should issue the paper money, as well as coin the gold and silver has taken a firm hold of the American mind."

3) They use extremely poor logic. For example they think they have logically "proved" that bankers will be honest, because in the long run it is good for business. That is mind-boggling and demonstrates gross ignorance of history and of business ethics in particular. I'm purposely gruff with the Austrians and Libertarians, because its what their viewpoint deserves. They have gotten away with it so far only because of the general ignorance of monetary history which allowed them to substitute a fictitious "theoretical" history, as Menger and the "free bankers" do.

4) They treat the banks statistically as if they were deposit institutions, but they were always banks of issue. Partly because statistics on the banks are very patchy, they have focused on certain measures which cannot convey a full and accurate picture of banking.

5) They ignore the stock fraud in bank shares, that always accompanied banking, etc, etc, etc. Recent history of the crash of 1929 indicates losses through

stock markets, from a banking created crisis was about 40 times as much as the direct losses in bank deposits.

In *The Lost Science of Money* I go into considerable detail on all these and additional points, because I feel it is important to expose this destructive movement by describing it objectively. *It is interesting that the great 19th century reformer Henry George also saw through the Austrians*, when he wrote in the Science of Political Economy:

> What has succeeded (in place of the classical school) is usually denominated the Austrian School…If it has any principles, I have been utterly unable to find them…This *pseudo*-science gets its name from a foreign language, and uses for its terms words adapted from the German - words that have no place and no meaning in an English work. It is indeed admirably calculated to serve the purpose of those powerful interests dominant in the colleges…that must fear a simple and understandable Political Economy, and who vaguely wish to have the poor boys who are subjected to it by their professors rendered incapable of thought on economic subjects…the volumes for mutual admiration which they publish…[22]

Later, Colonel E.C. Harwood, a twentieth century Georgist, and founder of the American Institute For Economic Research, carried forward this criticism of the

[22] George, Henry. *Science of Political Economy* (New York: Schalkenbach, 1992. Also see my essay on George and money at http://www.monetary.org/henrygeorgeconceptofmoney.htm).

Austrian School method, calling it "A LEAP BACKWARD" (headline):

> Dr. Von Mises denies not once but several times that his theories can ever be disproved by facts. This point of view represents a leap backward to Platonic Idealism or one of its offspring in various disguises.[23]

10. Advocates of "Local Currencies"

These are normally well-meaning attempts to remedy the shortage of national currency that undeniably exists in many localities. "Currency" is placed in quotes because these alternatives don't really rise to the level of currency in the sense that we use the term, but are more in the form of bartering or credit/debit payment arrangements. These systems can be traced back to Josiah Warren, the originator of the Labor Exchange idea, put into practice by Robert Owen in London in 1832 after a very tight money period. Mainly they enable participants to trade their labor, and some other items, with each other, without using the national currency.

The problem is that while these local systems do no harm and can help alleviate local cash shortages, they have been of very limited benefit; have usually required substantial self-sacrifice in terms of time and energy from those who have managed to keep them functioning; and have therefore generally soon ended. They will continue to be so limited until they can qualify as a *more true money form*. That is, in order for them to work more effectively, taxes (at least local taxes) have to become payable in such currencies.

[23] E.C. Harwood & Others; *Useful Principles Of Inquiry* (Behaviourial Research Council, 1973, Great Barrington, Mass., p.211).

We've made this suggestion to those interested in alternative "currencies," but there seems to be a mindset against involvement with government among some promoters. However the great uphill task these localized efforts face, plus continuing research will bring them to the realization that government per se, is not the enemy and seek alliances with government bodies. In that process one would expect that the taxing bodies would become involved in the issuing process.

Those who see their "calling" as advancing local systems should be alert to the possibilities open to them through a fuller understanding of the essential nature of money. To that end, the American Monetary Institute always stands ready to work with local currency devotees. A multi-faceted approach toward monetary progress, where various people do what they do best, has advantages. In addition it is possible that even after a sound national reform program is enacted, there may still be need for local adjustments. If that proves to be the case, our thinking at present is that local "strings" could be attached to a reformed national currency; strings designed for example, to help keep money circulating in local areas, and not just flowing back to money centers. Local activists are always welcome - and invited - to participate in fleshing out such "strings."

Unfortunately the bigger picture with such local currencies that must be stated and faced, is that even if they are made practical to use effectively, they do not stop the continued mismanagement of the monetary system at the national level. Localized systems can't stop the dispensation of monetary injustice from above through the privately owned and controlled Federal Reserve monetary system. And ending that injustice must really be a monetary priority.

In addition to this limitation, there are two potential dangers of local currency movements. First, they might distract otherwise concerned citizens from an understanding and a helpful participation in achieving national reform. Second they should beware of an agenda to mix local currencies efforts with Austrian/Libertarian free banking agendas. *Free banking, as we have indicated has already been tried and found to be among the poorest type of private money systems.* Furthermore this "free market" element actually agitates against the idea of reforming our unjust money system. This argument does not stand the common sense test. American money is and will remain a national item. To attack the idea of improving and reforming it is silly and not a point worthy of argument. What a gift to hand to those abusing the American people through our unjust, privatized money system!

11. Reforming the Federal Reserve System

Fortunately this is a monetary reform that can reach the goal for the nation to control its own money system. This is our best and most direct course of action - the real thing - and it could happen this way: In the next, (*or the next*) crisis created by the banking system, instead of bailing them out as usual at public expense, if there was enough awareness and public support, our government could nationalize the Federal Reserve; as England nationalized the Bank of England in 1946. Several past Chairmen of the House Banking Committee, including Rep. Henry B. Gonzales, introduced similar legislation over the years. The Proposed reforms of the American Monetary Institute:[24] First, nationalize the Federal Reserve System. Reconstitute it in the US Treasury, to evolve into a fourth branch of government. Only the government would create money. What would such government money look like? Well you have some in your pockets right now. Coin vs. Paper Money. Both are

[24] Abbreviated from LSM Ch. 24.

fiat moneys, but the coins are minted debt free and interest free by our government.

Second, remove the privilege which banks presently have to create money. This is done through an elegant process which automatically turns all the previously issued bank credit into real American money. 100% reserves are reached not by calling in loans but by increasing reserves with the U.S. loaning freshly created money at interest, to the banks. This is very different from simply demanding 100% reserves, which would wreck the economy. It would not be inflationary or deflationary, but would simply make real, what had been thought to be the monetary levels.

Third, institute anti-deflation programs for automatic, constitutionally determined government money creation, starting with the 2 trillion $ which the American Society of Civil Engineers estimate we need to bring our infrastructure up to acceptable levels. From there we go forward carefully determining how to best run the monetary system, and thoughtfully use Aristotle's method, *we learn by doing*. What difference would reconstituting the money power in government make? Government money goes into infrastructure; better life; better jobs; education, safer roads, cleaner water; better health care; social security, etc. Society is empowered by being able to direct the money power to solve pressing problems rather than into useless speculation. We no longer have to say we can't afford it, when so many people and resources are unemployed!

These three reforms can be closer than we think; and in a crisis situation if only 5% of the citizenry has an awareness of the societal/legal nature of money, they could be enacted. Such reforms don't happen in a vacuum. Progress is needed to correct erroneous but pervasive attitudes - mythologies really - of today's' economics. We therefore summarize four destructive thrusts of Adam Smith/Economics to beware of: The

Money "error, the Attack on Society/Government; the Smithian Free Trade Trap; and Smith's Selfishness Assumption.

12. The Attack on Government, Humanity, and Society

Beneath the battle of public vs. private money, there really lies an attack on government, which cannot be separated from society. This is especially important in monetary matters because we find that the modern 250 year attack on government originated largely in Adam Smith's efforts to keep the monetary power within the Bank of England Smith glorified the Bank and obscured its private ownership saying it functioned as "a great engine of state." He attacked government issued money.

> A revenue of this kind has even by some people been thought not below the attention of so great an Empire as that of Great Britain...But whether such a Government as that of England - which, whatever may be its virtues, has never been famous for good economy; which, in time of peace, has generally conducted itself with the slothful and negligent profusion that is perhaps natural to monarchies; and in time of war has constantly acted with all the thoughtless extravagance that democracies are apt to fall into - could be safely trusted with the management of such a project, must at least be a good deal more doubtful. (Adam Smith, *Wealth of Nations*; p.358 – in the Great Books collection, vol. 39).

Smith's insulting attacks on the English Government marks the modern beginning of a relentless attack on society - the belittling and smearing of its organizational form - government. *The single organization potentially able to block plutocracy's encroachments.* Smith also inadvertently illuminates the major purpose of this attack: - to keep the money power in private hands.

Every day in America we see examples of how this disease has reached epidemic proportions. It has spread from the Austrian economists, and Hayek and Ayn Rand (the Muse of our Fed Governor, Alan Greenspan) to their intellectual heir Rush Limbaugh and his propaganda radio. Moreover we find that the fraudulent attack on government money is also at the base of sources of the "freedom diversion" as practiced by many Libertarians. An example is how Robert Nozick launches his *State, Anarchy, Utopia,* one of the Libertarians' bibles, on Menger's false notion of the Origin of Money.[25] [26]

13. The Free Trade Trap

In addition to Smith's Monetary Error and his Attack on Government/society, there is what's been referred to as "the Smithian Free Trade Trap." To understand this trickery as it relates to international trade, now

[25] This "origin" was originally put forward (in "modern" times) by John Law in his book Money and Trade Considered. Law was blamed by many for bringing down France's money system in the early 1720s. Carl Menger, the founder of the Austrian School of Economics, resurrected Law's theory in his Principles of Economics (1871). Despite its name, this school is primarily active in the U.S. Their ideas have been taken up in late 20th century America by the Libertarian political party. For example, Robert Nozick used Menger's "Origin" to launch (p.18) his book, *Anarchy State and Utopia* (New York, Basic Books, 1974), one of the Libertarians' 'sacred texts'.

[26] Menger's theory is an example of Austrian monetary illiteracy, as shown in AMI Research Paper # 1 titled *A Refutation of Menger's Theory of the Origin of Money*, which is available from http://www.monetary.org.

Globalism, one simply must read Frederich List's *National System of Political Economy*.[27] List showed that while England aggressively promoted Smith's "free trade" ideas to other countries, she pursued a very different policy herself, which was to import raw materials and apply mechanical power to them in a production process. England was thus applying the principles of the industrial revolution, but tried to hide that fact from other nations.

The "Freedom" Mantra is now placed on all sorts of doubtful practices to cleanse their image and shield them from closer scrutiny. For example, the Iraq horror is officially termed "Operation Enduring Freedom." By labeling any activity, however criminal, with the word "free," you are expected to kneel and worship it. "Free Market" Worship shows itself to be more a religion to be obeyed, rather than an economic policy to be analyzed and critiqued. The market is held to be omnipotent, omniscient, and beneficial – the three attributes of a deity. A strange deity that abhors morality; served by an Austrian/Libertarian priesthood that confuses Ayn Rand novels with historical experience. One of the reasons I come down so hard on the Libertarians is that considering the educational opportunities they have received, we should expect much better from them. It's a stylistic two by four across their heads to draw their attention to their methodology problems.

The "Free Banking" Movement is one example and we have already discussed it above. There's now a danger that the Austrians will try to channel local currency advocates toward a form of free banking. We have already been down that dead end road, and it would be a shame to divert otherwise healthy people into wasting energy there.

[27] Available on AMI's website.

14. Adam Smith's Selfishness Error

Finally, regarding the moral fallacy of Smith's "selfishness," Henry George noted: "Dr. Buckle's understanding of Political Economy was that it eliminated every other feeling than selfishness. Wherein Smith 'generalizes the laws of wealth, not from the phenomena of wealth, nor from statistical statements, but from the phenomena of selfishness; thus making a deductive application of one set of mental principles to the whole set of economical facts. He everywhere assumes that the great moving power of all men, all interests and all classes, in all ages and in all countries is selfishness…indeed Adam Smith will hardly admit common humanity into his theory of motives.'"[28]

Consider the negative impact on humanity of Smith's selfishness assumption: if Man is defined in such a base manner and systems of laws with their rewards and punishments are enforced along those lines, then over time, they will tend to create a form of humanity in "harmony" with their false concept of an economic mankind.

This de-evolutionary process, encouraging a lower form of humanity has been ongoing especially in the English-speaking world for well over two centuries. The work of great English novelists such as Charles Dickens may have slowed it, but didn't stop it. Henry George saw exactly where it would lead:

> Nor can we abstract from man all but selfish qualities in order to make as the object of our thought…what has been called 'economic man', without getting *what is really a monster, not a man.*[29]

[28] George, *Science of Political Economy*, 89, 90.
[29] Ibid., p 99 (emphasis added).

George substituted a different concept for Smith's destructive error: "The fundamental principle of human action … is that men seek to gratify their desires with the least exertion."[30] Then taking a giant step, he poetically described the essence of humanity: the "Force of Forces**":**

> It is not selfishness that enriches the annals of every people with heroes and saints… that on every page of the world's history bursts out in sudden splendor…that turned Buddha's back to his royal home or bade (Joan of Arc) lift the sword from the altar; that held the Three Hundred (Spartans) in the Pass of Thermopylae, or gathered into Winkelreid's bosom the sheaf of spears…Call it religion, patriotism, or the love of God - give it what name you will; there is yet a force which overcomes and drives out selfishness; a force which is the electricity of the moral universe; a force beside which all others are weak…I call this force destiny toward human nature - a higher, nobler nature than we generally manifest…And this *force of forces* - that now goes to waste or assumes perverted forms - we may use for the strengthening, and building up, and ennobling of society, if we but will…"(P&P, 463)

[30] George, Henry. *Progress and Poverty*. New York: Schalkenbach Foundation, 1992; p. 203.

15. Conclusion

Look around yourselves and you will see evidence that Henry George was correct. All of you could have probably found easier ways to achieve profit and or power; comfort and or repose, than the life tracks you have chosen. I'll guess that a main factor in your choices has been a reaction to the need for justice, not merely utility in human relations. We need to spread that worldview and basis for human action, by giving proper respect when we see it in others; in our writings and talks and relations. And always remember that morality and greater fairness in society are ultimately highly utilitarian. People do (and should!) react to being treated honestly. The ramifications for their society means that justice, in particular basing our money systems in fairness, is a highly useful policy. In this process we can give those who presently obstruct human development for private gain, what they've denied to the rest of us, we can give them justice too.

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Toward a Non-capitalist Market System: Practical Suggestions for Curing the Ills of Our Economic System

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Abstract
The paper focuses on the reform of economic institutions –those of the market mechanism and the financial system, in particular. After introducing the analysis with an historical excursus on the development of economic institutions, the intent here is to propose significant modifications of the present market and financial establishments, which despite their radical flavour, will be shown to be, in fact, no less pragmatic than indispensable to cure the economic maladies of our age. Throughout the modern times, all spokesmen of powerful institutions –e.g., churches, governments and economic elites—have always been keen to recognize in principle that these bodies are never perfect, and that societies assuredly need to take a step back, so to speak, ponder things over and eventually improve them. This is exactly what we set out to do in these pages: namely, we wish to lay the foundation for such an analysis of market developments, and thereafter suggest the remedies for making society a workable economic proposition.

JEL CODES: P19, D49, D39, E43, G29, F02
KEYWORDS: Capitalist system, Dynamic competition, Income distribution, Interest rate, Financial institutions, International economic order

American Review of Political Economy, Vol. 3(1), Pages 85-126, March 2005

1. Introduction

This essay analyses a central question of modern society: how does one best use 'the instrument of the market' –this being a basic mechanism of organizational efficiency in dynamic economies characterized by a high degree of uncertainty—, in such a way as to prevent the market itself from turning everyone and everything into expendable tools, with consequences that are ever more disastrous for equity and for human dignity?

The purpose here is to envisage the possibility and, more importantly, the necessity of economic forms adapted to human society that are *different* from those that have emerged from the spontaneous transformation of the Western world. Persisting in the denial and ignorance that such a possibility of *change* is indeed possible will inevitably lead to the (often fanatical) conviction that the capitalistic market, with all its degenerations and inefficiencies, is the unavoidable, even if bitter, outcome of institutional evolution—a necessary, teleological fruit of human exertion: 'the end of history'.

To analyse this topic with the depth and the breath it deserves, we will first sketch a brief account of those institutions and forms of civilisation that in the course of history have promoted the rise and spread of the market, eventually making it into an organizational necessity of modern economies. This account will be concluded by a summary of the pros and cons of the capitalistic market. The subsequent step concentrates on the notion of *competition*, and in particular on the role of the *entrepreneur* and the significance of the rate of profit as a gauge of accountability. This is essential in order to highlight the powers of resilience of the market, and to show its flexibility as an organizational tool with regard to various kinds of ideological options: for instance we will contemplate how it may be extended to either private or public systems of ownership. In section 4 we discuss how the market may be turned into a mere mechanism for the imputation of costs and efficiency, and this discussion is at the heart of the following proposal for a non-capitalistic market and the merits of its social openness. This argument will then lead directly to the treatment of a defining, and fundamental component of the system, upon which all reformist propositions impinge by necessity: the nature and management of the interest rate and the attending financial system. These are two dominating and interconnected aspects of traditional economic systems that increasingly thwart entrepreneurship and stifle production since they are predicated on a high concentration of economic power in the hands of a social class de facto devoted to speculation rather than production. We offer a solution to this problem, and conclude the article with a few considerations on the international order.

The goal here is to devise a coherent reformist agenda articulated in several key points pertaining to the vital nodes of the economic system[1]. This is just a beginning, a first attempt: naturally, given the complexities of the issue, the remedies recommended are by no means exhaustive, but merely indicative of the broad path all humanist forces should undertake together in days to come.

2. An Historical Sketch of the Market

In this section, which is devoted to ages in which the market was hardly the protagonist, we will identify the structural obstacles that impeded the development of market relations and the contingencies that eventually allowed those relations, in some instances, to rise gradually and spread all around. We then consider the

[1] The development on the method of social science exposed in Fusari (2004) may allow a better understanding of this essay.

strong interaction between the growing influence of the market and the rapid pace of social transformation, which has brought the market to become the essential mechanism for efficiency, growth and development.

In ancient times markets were absent or marginal because they were not necessary to the organizational efficiency of social systems; rather, as we shall see, the market obstructed efficiency. The major role played in some ancient societies by individual initiative, critical spirit and the propensity to adventure was much more a stimulus to creativity, scientific research and geographic discovery than it was to the market economy. The economy did not hold a central position[2] and did not attract the interest of students and practical men. Of course, the great empires of the ancient world devoted considerable resources to hydraulic, monumental and military works. However, these were centrally administered, authoritarian societies that suffocated individual initiative, and in particular mercantile activities. Which does not mean that they could not achieve wealth, power and social sophistication: in fact, a stationary-repetitive economy may be efficiently managed by centralized processes and bureaucracy. Indeed, the most advanced societies of the ancient quasi-stationary world were bureaucratic, autocratic and centralized empires, whose neatly ramified branches often afforded complete and efficient control over extensive regions, avoiding thereby the dissolution and fragmentation.

The crises of the two main commercial empires of the ancient world, Cartage and Athens, are good instances

[2] In the few ancient societies based on the activities of traders, like the Phoenicians and a few other *poleis* situated on caravan routes or along the shore, trading did not engender a cumulative development. Such a failure condemned them to extinction or subordination.

of such a tendency. Those empires were defeated by less rich but more highly structured rival powers. The organizational inconsistencies of the two empires, the avariciousness of their ruling classes, and the resentment of their confederates and subjects, all represented heavy functional handicaps in the static outlook of both systems. But the best illustration of the market's unsuitability to quasi-stationary societies is provided by the experience of the Roman Empire from Augustus to the Antonines. That empire was governed by highly advanced institutions, suitable to the modern world and unique in ancient times. An active and efficient body of public servants authoritatively administered justice, public order and taxation; the remaining public functions were assigned to the municipal self-government of the decurions;[3] individual initiative was well represented and taxation low. But the major pride of the empire, the great Greco-Roman civilization with its central idea of circular time, and the marginal role of the economy, the running of which depended on the polarisation aristocracy-slavery, hindered cumulative development and the role of the market.[4] The persistence of stationarity, hence stagnation, transformed the promising decentralized public administration of the empire into a factor of dissolution.

[3] These were the members of the councils of the urban communities, who were vested with deliberative power and competence on local finance, building, public works, and public utilities.

[4] The enormous economic power of the Roman aristocracy grew over time as a partial compensation for the political influence subtracted to Senatorial class by the emperors and their civil servants. But aristocratic culture disregarded economic productivity and influenced the culture of the merchant class, and slavery made possible the sustainability of such culture. On the other hand, the Christian-Judaic notion of linear time was obscured by the dominating civilization.

So the great crisis of the third century A. C. and an extremely painful process of trial and error drove the Roman Empire toward the bureaucratically centralized, hierarchical society of Diocletian and Constantine the Great. In that society, as in the other great empires, the market was clearly marginalized.

The collapse of the Western Empire –which, unlike the Eastern provinces, was socially and economically dominated by large estate slavery tenancy and a large state subsidized urban populace— resulted in a severe retrogression in the general conditions of development. In this new stage of arrested growth, the body social reverted to a primitive structure governed by familial links: the quasi-familial relations of loyalty on the part of the populace to the descendants of the great Senatorial landowning class, or to Germanic military chiefs, assumed a basic role. No proper State power came into being. The sovereigns of the barbaric states were for the most do-nothing kings, controlled by a military aristocracy. Nor was there any centralized or autocratic empire in fragmented post-imperial Europe. Charlemagne's empire was a kind of "shooting star". After his death, social organization took to the feudal model: a world governed by strong and arrogant individuals, plunderers more than administrators; as Anna Comnena noticed during the transit through the Byzantine Empire of Crusaders' expeditions: these were fighters for the faith, but also for spoils and fortune, "extremely greedy for any kind of gain."[5]

[5] See A. Comnena, *L'Alessiade* (Stamperia Andrea Molina, Milano 1849). Cupidity was very widespread, even among true believers. The crusaders of Peter the Hermit devastated the Balkans to a surprising degree, pillaging and slaughtering. They greedily ventured into Anatolia, too impatient to wait for support, and were promptly exterminated.

In such turmoil, what became of the market? The Western European world dominated by avidity and the spirit of independence, and well disposed to adventure, favoured a luxuriant efflorescence of mercantile activities. The maritime towns were clever at making huge profits from the Near-eastern conquests and the growing hunger for exotic goods. The medieval Communes that followed, carefully created laws, and institutions suited to trade, and were resolved to defend and extend their independence by fraud, talent and the sword. The economy began to take on a central role; it now wielded progressively political power and came to finance troops and mastermind conquests. Innovations became more frequent, and while they might have appeared at first to be of little importance, they contributed greatly to productive efficiency. Ancient Chinese inventions were adopted; others were rediscovered in the Arab world, which had been driven into decline by Islamic theocracy, despotism and the vice and decadence, as deplored by Ibn Khaldun.[6] The figure of the so-called merchant adventurer arose and the drive for discoveries and profit opportunities intensified.

This triumph of individualism and activism contaminated the intellectual milieu of Europe. Philosophy and scientific investigation flourished. The religious world, cultivated in the monasteries, which held a monopoly of knowledge, now began to court heterodoxy. The spread of heretical groups and then the explosion of the Protestant Reformation made theocracy

[6] See Ibn Khaldun (1958). He was a great Arab historian and traveller across *dar al Islam* that lived in the fourteenth century. He wrote an important and voluminous history of Arabs, Persians and Berbers, in which he fashioned a peculiar theory of historical processes. Through his creative analysis he identified the cause of the decadence of Arab world in the excesses of absolute power, injustice, unproductive expenditure, nepotism and corruption.

impossible. The idea of linear time, which infused the perception of "becoming" and the sense of expectation, once it became wedded to a pluralistic, decentralized social structure permeated by the individual search for material wealth, ended up fertilizing the soil of commercial spirit and economic activity. A world open to creativity and change wedges its way into history.

Nevertheless, until the sixteenth century, there was no such thing as the self-sustained growth of the economy. Despite the progressive build-up of this pre-modern "dress rehearsal" for capitalism, Western Europe was still less developed than China, though it had a key advantage: entrepreneurship. In fact, the great geographical discoveries of Ming admiral Zheng-Ha in the early fifteenth century had no effect on the centralized Celestial Empire, hostile as it was to businessmen and inclined to isolate itself from the outside world. By contrast, the European Age of Discovery was an epochal turning point, driven mainly by the impetus of merchants and adventurers. The growing dimension of the market began strongly to stimulate labour division and hence labour productivity.

Still, the immense flows of resources that accompanied those events and the appearance of manufactures could not by themselves have averted European society's relapse into quasi-stationary motion (even if at a higher level of development), or even disintegration and the extinction of creativity, as in ancient Greece. This danger was averted thanks to the immense contribution of science. Henceforth, economic competition would be based even more strongly on innovation –Schumpeter's "creative destruction." The era of industrial society began and capitalism was fully established, at last.

The rise of a dynamic social system made the market a crucial organizational necessity. In fact, it is impossible for bureaucracy to govern a dynamic

economy, which by definition is characterized by great uncertainty, and which needs a steady supply of creativity and innovation. Bureaucratic organization inevitably leads to the stationary state. Entrepreneurship, creativity and innovation need the market, which is the sole mechanism that can coordinate a large quantity of disconnected initiatives and conflicting decisions in a radical state of uncertainty, and eventually assure their overall consistency while providing adequate incentives for all activities.

The central role of the economy and the need for the market –both of which imply the ontological imperatives of individual action, creativity and inquiry— allowed the progressive destruction of the centralized, authoritarian societies that had submerged the world until modern times. The extremely peculiar causes of this turning point are well exemplified by the case of Japan: a society that, despite many affinities with European feudalism and decentralization, was unable to free itself from stationary motion but relapsed into a centralized Shogun feudalism that lasted until the Meiji revolution of the nineteenth century. This result, starkly different from that of Western Europe, can only be attributed, primarily, to the lack of the capitalistic market.

3. The Capitalist Market

This section focuses on the capitalistic nature of the evolutionary process previously discussed. In particular, it underlines the initial propulsive strength of the capitalistic market and proceeds to single out its growing limitations, which appear to form an explosive blend of contradiction, discontent and inefficiency in the present age.

In the eighteenth century, Mandeville emphasized the role of selfishness and corruption in driving society to prosperity and dynamism.[7] Soon after, Adam Smith's economics celebrated the "invisible hand," a metaphor for the combination of the market with individual interest. Both were right as commentators of their own era. In fact, the robberies and lack of all ethical constraint on the part of merchants and entrepreneurs were crucial to primitive accumulation; they were the prerequisite for the advent of industrial society. Well-governed social orders, like the great empires or Tokugawa centralized feudalism, were unable to promote endogenous growth, which was stimulated above all by the lubricating role of the market and self-interest. However, Mandeville and Smith went too far in asserting that these phenomena represented *natural laws*.

Secularisation proceeded, promoting the theory of separation of economics and politics from ethics, and thus silenced the grumbling of the moralists. Such separation represented an evident scientific error. As a matter of fact, social sub-systems always interact: they cannot be separated. But the scientific mistake operated very well in practice: it eliminated the submission to some ethical rules that contradicted various organizational and functional necessities of the new, modern world. Besides, it stimulated the alluring powers of material incentives and the role of the market. This drift accelerated the completion of the great march towards the *open society*, which gradually smashed the closed and authoritarian civilizations that were still left standing.

The accumulation of financial capital represents a central aspect of dynamic economies: an acute hunger for capital has accompanied the evolution of capitalism

[7]He was persuaded that «personal vices may be made useful, by a clever government, to the worldly happiness and the greatness of the whole» See B. Mandeville, *The Fable of the Bees* (Laterza, Bari, 2000, page 5.)

from its first steps. In Medieval time, international traders from Italy invented a peculiar institution called *collegantia* to collect the commercial capitals they necessitated. Loan at interest and discounting (of commercial bills) was diffused in Medieval fairs. Banking system came to know a rapid diffusion. Amsterdam, and later London, became the heart of a powerful world capital market. The domination of finance capital had just started. The management of interest rates became the crucial mechanism of the monetary system, and speculative activities gradually ousted production from center stage.

The moral impudence of market relations and standard financial maneuvers soon began to engender disgust and moral disapproval, which were strengthened by intensifying exploitation. This development gave birth, in the realm of social thought, to a great error, well expressed by Polanyi: namely the idea that the market is just one of various organizational possibilities and that it can therefore be discarded in favour of a different one, say, a "redistributive" (Socialist) system. Such a conception found expression in a variety of utopian designs, which were for the most part fuelled by indignation over the infamies of the market and its agents, and which all called for the abolition of the latter. The aims of anti-market utopia, however, never seemed to go beyond the notion of the stationary state and the closed society, which ultimately signify regression to retarded stages of development. This was shown clearly by the most distressing of such utopias, Communism, which aimed to eliminate the market but never escaped its influence, from the early period of the NEP under Lenin's tyranny up to the recent collapse of all the Socialist systems. The methodological equivocations afflicting social theory obscured the fact that the market, entrepreneurship and individual initiative are simply organizational necessities in modern dynamic economies and the open society.

The only critique of the market based on scientific foundations appears to be the analysis on “market failure,” according to which, the market is in some instances found incapable to act efficiently, in particular with reference to public goods, and when market demand for goods is insufficient to absorb production. As a routine, governments –colluded with business—have encouraged a large expansion of public expenditure to remedy the deficiency of demand, and therefore allow the market to ‘digest’ less troublingly. Yet this routine was gravely flawed from the outset: it disregarded the efficiency of the public sector and of the public administration. This oversight stimulated the birth of an alternative approach that emphasized “government failure,” which, coupled with the fall of “real Socialism” in the East, greatly strengthened the market fundamentalists, and thus boosted the advent of the so-called *new economics*: a gospel preaching absolute free trade and a blind faith in the free market.

Meanwhile, rapid development of communications has allowed market relations to envelop the entire planet with thousands of tentacles, transforming the open society into a *global society*. Thus the free market has become the owner of the world, with the devastating presence of the four modern Horsemen of the Apocalypse: distributive iniquity, growing international disequilibria, social disintegration, and mass unemployment. These phenomena are most acute in the underdeveloped countries, but they do not spare even the heartland of the free market. In the United States, following the trend in the concentration of wealth, the difference between the highest and lowest personal income groups has almost trebled in the last forty years. The earnings of a CEO are almost a thousand times those of a simple workman, while public opinion is

increasingly concerned over the unspeakable abuses of corporate power. The transition in the former Socialist countries has almost always taken the worst of the market economy: privatisation has usually produced massive frauds and corruption.

Everywhere around the world one may see the astounding facility with which the free market makes instruments of everyone and everything. The necessity of the market favours the diffusion of so-called capitalistic ‘ethics’ and ‘civilization’, even if they are not strictly necessary to market institutions. So, an insidious kind of colonization is at work, which people accustomed to different cultural values have come to hate with a passion. As mentioned before, not even the Western world can blindly trust the sorceries of the free market.

A highly dynamic society is obliged to cultivate a diffuse solidarity and a deep sense of cooperation to defend individuals from uncertainty, precariousness, loneliness and frustrations, which rapid social change is wont to inflict on man. Here, contrary to appearance, we have a basic inconsistency of the present historical era with the idea of a spontaneous social order. Today, moreover, the virtues of public expenditure in recreating the structural consistency between production and socialization have disappeared, having the public deficit become a constraint instead of a stimulus to production. As we shall see later, such consistency now requires to make the market a mere mechanism of imputation of costs and efficiency. This is an important new *organizational necessity* of modern social systems. The race for earnings may itself foster the worst misdeeds and has, from a moral standpoint, incredibly destructive power. We have seen that the ability on the part of market relations to furnish incentives, during the march towards the open, global society, was intensified when it came to be combined with non-ethical behaviour. Today it is ever- more indispensable to link market relations to higher level of ethics. The global dynamic impulse of the separation of ethics from politics and economics in social thought and action is beginning to turn into an obstacle to the growth and development of human societies.

The high level now attained by the general conditions of development and the growing social maturity of the masses make the persistent phenomenon of "power as domination" ever more indigestible, a factor of growing contradiction. The transition to "power as responsibility" is urgent in both politics and economics. One of the great merits of the market is its capacity for automatic, objective and inflexible attribution of accountability for the results of daily economic activity and decisions. But it is necessary to flank this responsibility with an equally objective and inescapable responsibility to the laws governing market relations, so as to avoid, for instance, bribery and corruption, which also undercut economic efficiency. The crucial imperative today is, again, to disengage the market from its inclination and ability to turn all of us and the world at large into its tools.

Let us provide a set of solutions to this problem.

4. Entrepreneurial Role and Profit Rate. The Public and Private Spheres Within the Working of the Market

In this section we will identify some precise organizational requisites for the establishment of a wholesome entrepreneurial economy. Such a careful definition will enable us to combine our revisited model with diverse ideological options.

We have just seen that modern economies cannot do without entrepreneurship and market relations; and that the market's automatic, objective attribution of the entrepreneurial responsibility for action and decision is a precious device. Both in private and public companies (operating for the market), the only reliable indicator of

success and hence of responsibility is the profit rate.[8] All other significant indices refer only to particular aspects of entrepreneurial action; they are partial and may accordingly become misleading.

Various economic theories maintain that the entrepreneur is interested in total profit, not in the profit rate. But total profit is not a ratio of return; therefore, it does not represent an indicator of entrepreneurial success. The search for total profit demands that investments be ranked on the basis of their earning rate, if the global activity of the firm is constrained (as it always is) by the availability of some factor of production.[9] But the profit rate is a good indicator of success only if it is obtained in a competitive market, not through monopoly, for competitive markets force the entrepreneur to engage in a ceaseless struggle for profit, and thus bind him to his function and his responsibilities.

To avoid misunderstandings on this crucial matter, an important specification on the notion of competition is required. The competition based on the entrepreneur's search for profit is the one considered here. It may also be intended as a combination of Kirzner's "market process" and Schumpeter's "creative destruction."[10] This notion of competition seems to be the only appropriate one in a discursive analysis of modern dynamic economies characterized by innovation and uncertainty. But a complication arises: successful innovation causes temporary monopoly. The complication is only apparent, however: in fact, an innovator's monopoly does not

[8] The well-known Lange and Lerner's rules, that should drive the entrepreneurial behaviour in market socialism, make sense only in a static economy, that is excluding innovation and uncertainty. Therefore, they cannot be referred to reality.

[9] This clearly appears from the formulation of a problem of optimisation under the constraint of the available entrepreneurial skills (or some other scarce factor).

[10] See I. M. Kirzner (1973) and J. A. Schumpeter (1954).

cause restrictions to competition, rather it is the engine of dynamic competition. Therefore, anti-monopolistic vigilance must not target this kind of monopoly, which will vanish as soon as the incumbent innovation will be undermined by a superior one –and that is, as soon as the benefits for the community deriving from the original innovation cease. In short, an innovator's profits express the success achieved in the performance of entrepreneurial function, not a privilege.[11]

Under this set-up it will be important to prevent that entrepreneurs falsify the accounts with a view to showing larger than actual profits, and so deceive bankers and other financiers. In public firms, such falsifications may also be triggered by the aim of avoiding blame. The greatest watchfulness is therefore required.[12] Some standard corporate accounting

[11] In Neoclassical economics, price competition results in allocative efficiency. However, this is a result of comparative statics as opposed to a dynamic process. This is like taking a series of pictures--the economy that results is stationary: it does not move--the process by which we go from one point to another is an illusion, just as a motion picture provides the illusion of movement. However, since the movement from one point to another is not considered, the efficiency that results is one that is based only in the moment and is, thus, a stationary efficiency. The notion of competition relevant in this context does not imply such stationary efficiency. Indeed, neoclassical competition is almost senseless; a stationary economy does not need the market.

[12]In workers self-managed firms the falsifications are stimulated by the interest of workers to increase their earnings. A way of exaggerating profits may consist in the underestimation of capital depreciation and, on the part of banks, in the concealment of the losses due to the insolvency of the financed concerns. But these manipulations (directed to hide losses) will depress profit rates of the successive years, since they will cause a fictitious growth of capital, and will thus force the firms performing those tricks to feed a growing fraud

procedures have been devised at the EU level to facilitate monitoring and gauging corporate profitability. Other controls on corporate results are used for tax purposes. It is important to perfect them. We shall see that the main difficulties in auditing business accounts are due to the confusion and complications of international relations. The situation is aggravated by widespread bad faith. In effect, the alarming frauds reported in the press are possible only because of the "kindness" of the authorities, which turn a blind eye; such complicity must be harshly repressed.

The basic characteristics of the market as set forth here do not, at first glance, imply any theoretical innovation. However, their strict essentiality has substantial analytical value. Our model implies the unrestricted possibility of combining the market mechanism with a large number of different institutional, ideological and relational forms. In particular, our concise analytical foundations allow us to deal with the problem of property free from prejudice, inhibition and mystification, making evident that private ownership may be severely limited by public firms operating in the market without damage to efficiency and with some important advantages for social justice and the control of the overall rate of accumulation, and thus of aggregate demand. For in this kind of firm, profit serves only as the indicator of entrepreneurial success, which should determine whether the managers are kept on or discharged, and not as the vehicle for personal enrichment or unconstrained speculation.

As is well known, private property is one of the institutions that have vaunted, in the course of recent centuries, the greatest merits and demerits. It has been at one and the same time a great source of freedom and

over time, which would become increasingly more difficult to conceal.

of oppression. It has been the main barrier against the stifling domination of public institutions, it has stimulated pluralism, it has been an important source of individual incentive, and it has constituted an important defensive shield of personal independence. At the same time, it has greatly stimulated and inculcated greed and it has been a formidable means for the exploitation of man by man, and for countless other abominations. Moreover, it has fostered an enormous concentration of power. How are we to separate virtues from drawbacks, to preserve the former and eliminate the latter?

This problem largely coincides with the question of delimiting the appropriate sphere for private property, while guaranteeing freedom and justice for all citizens.

We can set out a general principle: *private property should be preserved in so far as it promotes productive efficiency, the satisfaction of citizens and the full appreciation of their qualities and aspirations, without implying the creation of dominant positions.* Both durable and non-durable consumption should be included in the sphere of private property, in particular homes, gardens and intensively cultivated plots of land. Moreover, small farms, craft and commercial enterprises, whose success is difficult to monitor and hence to control, should be privately run. For efficient performance, these firms need the dedication that comes from private ownership and private appropriation of profits. And as these firms are small, they do not imply dominant positions.

In this economic system, everyone can consume what he wishes, as the search for profit will push firms, driven by prices, to satisfy consumers' preferences. Here the question of new goods and the manipulation of demand through advertisement arises. The introduction of new goods and services is of critical importance for consumers since it broadens their range of choice. Furthermore, in the absence of new products, consumption would be saturated and the economy

would stagnate. The entrepreneur produces new goods if he thinks they will be bought. But new goods require advertisement to inform people of their existence. What must be condemned is false, misleading advertisement, not informative publicity. It is undeniable that the purpose of publicity is always to influence consumers. But the purpose of any message whatever is always to influence the listener. The only guarantee against the risk that such influence may create a dominant position, which jeopardizes freedom, is pluralism.

5. The Cycle of Production and Distribution within the Market Operating as a Pure Mechanism of Imputation of Costs and Efficiency

We are about the broach the core of our reformist proposal. Its goal is to delineate the widest possible bounds of social equality, in ways that are consistent with freedom, efficiency and development: in other words, we are seeking to find the preconditions guaranteeing the highest degree of social equality that modern society may achieve.[13] The pursuit of these aims requires the transformation of the market into a pure mechanism of imputation of costs and efficiency. Such a transformation needs the establishment of a special fund; therefore some preliminary considerations are necessary to clarify the nature of this fund.

The rapport of economics and social science vis-à-vis the market is twofold: on the one hand, the market has been considered as a potent vector of immorality, instability and social precariousness, and because of

[13] The treatment of this topic bears some resemblance to J. Rawls' investigation (see J. Rawls 1971); but our analysis is more specific and operative than that of this author, it being specifically concentrated on the concrete management of market relationships.

this, many have called for its wholesale abolition; on the other, the market has been understood as an institution indispensable to the efficiency of production, which, at most, is allegedly thought of requiring but the complement of social welfare to run perfectly. We saw that the first course of action is completely senseless in modern dynamic societies, while the second perspective appears nowadays utterly insufficient.[14]

We wish to offer a different model, which operates a profound transformation of the market mechanism, and which is predicated, among other things, on the creation of a special fund. This fund of community wealth should enable the system to conjugate the achievement of the highest possible productive efficiency with freedom in the distribution of income. More precisely, it will be proved that this fund is crucial to the pursuit of four main aims: business efficiency, distributive justice, full employment, and individual autonomy. As far as we can tell, there is no example of such a fund in the present and past ages. Let see how our suggested model functions by starting with production.

In this model, the firm buys the goods, factors of production and services required by its productive decisions on the market, at market price, just as it does today. But it does not pay wages; instead it pays the price of labour as computed by work offices on the basis of the demand and supply of the various types of

[14] The debate on market Socialism in the years between the two world wars, was hinged on the hypothesis of a stationary economy, which does not need entrepreneurship, and thus made room for the formulation both of a centralized model of the economy, as that elaborated by E. Barone in the essay on "The Minister of Production in the Collectivist State," as well as of that of a decentralized model of market socialism, with the manager's decision–making simply dictated by Lange, Lerner and Taylor's rule. (See A. P. Lerner 1938, O. Lange and F. M. Taylor 1938).

labour[15] into what we may call a "fund of community wealth." However, the firm may pay incentives to its workers and also overtime, if it deems it advantageous.

Moreover, companies will pay into the fund a penalty for any damages to the environment; conversely, they should receive contributions for any social benefits deriving from their action. Firms are also taxed. Finally, they may have to pay into the fund a surplus over regular labour cost to assist the transfer of workers from the district of origin. The purpose of this is to stimulate capital to flow toward labour, so as to minimize the effects of uprooting, congestion and urbanization generated by migration.

At the end of the production phase, the firm will sell output at market prices. With the proceeds, it will cover constant and variables costs, including capital depreciation and costs on borrowing, as well as taxation. The difference between revenue and costs, divided by capital employed, yields the profit rate.

In addition to incentives and overtime paid directly by the firm, workers are entitled to a portion of the fund of community wealth. The determination of this portion and its distribution among social groups will follow criteria defined outside the firms, in the political sphere and through negotiations among social groups and their representatives. The share of each occupational group in income distribution may also depend, in part, on supply and demand for each kind of labour specialization; that is, each group's share may be augmented or decreased, depending on whether demand for that type of labour is greater or less than

[15] As is well known, demand and supply give, by themselves, relative prices. So, to obtain the prices of nominal labour it is necessary to refer to some labour price expressed in money units or, taking variations, refer to initial prices expressed in money units.

supply. In this way, the balance between labour demand and supply will be fostered by variations of supply, not only by the reaction of demand to changes in the price of labour. Each worker will be entitled to receive, from the fund of community wealth, a compensation proportional to his working time (but not overtime work, which as noted is paid by the firm) multiplied by the hourly compensation for his skill. To reduce transactions, firms themselves may pay this compensation, deducting it from their payments to the fund of community wealth.

At the end of each year, along with the share of output to distribute to labour in the next year, the average gain in labour productivity will be calculated and the share of that increase to be allocated to labour income and the share allocated to a reduction in working time, will be set. This allocation converts technological progress into higher labour income and free time, not unemployment.

People look for jobs by direct contact with firms and following the suggestions of labour exchanges, which have the knowledge of the demand and supply conditions for various skills (because they monitor demand and supply in order to set the price of each skill that firms have to pay into the fund of community wealth). Everyone chooses the job he finds more gratifying (by the type of activity, responsibility, distance from home etc.) and, if he is satisfied, he will keep his job; otherwise he will continue to search for more satisfactory employment. In case of collective dismissals, due for instance to a firm's closing or downsizing, the dismissed labourers will receive benefits for the time needed to find another job.

We can see that this model does not consider labour as a commodity that wage earners sell to the firm but as a service to productive system that entitles the worker to share in income generated. To prevent people from choosing not to work, in fact, the principle must be that

except for those unable to work, the condition for a person to share in the community's income is that he be employed.

In this organization of production, large-scale long-term unemployment is prevented by the perfect flexibility of the price of labour with respect to demand and supply for various skills. As the price paid by firms for the use of labour skills is determined by the labour exchange on the basis of supply and demand, a labour glut would drive down its price and cost, and thus stimulates firms (in the search for profit) to employ more labour and adopt capital-saving technology. The opposite happens if labour is scarce. This should push labour demand and supply toward equilibrium[16]. The tendency is strengthened if the education system produces versatile workers, enabling people to find various kinds of gratifying jobs. But to move the economy toward full employment it is also necessary to pay attention (to this we will return in the next section) to guaranteeing the equilibrium between aggregate demand and supply. This need is particularly strong in modern dynamic societies, with their continuous local and global changes and adjustments. Even more, one must consider that knowledge and its evolution come largely from experience; [17] so that people excluded from the productive process are also excluded from important channels of knowledge and will be increasingly unable to avoid marginalization and alienation.

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[16] Sraffa's demonstration of the re-switch of techniques is not relevant in this context, it only shows the erroneousness of the notion of average period of production and of the explanation of the interest rate on the basis of capital productivity; moreover, it makes the hypothesis that wage rate is exogenous, that disregards the relation between wage rate and the supply and demand of labour.

[17] M. Polanyi's pioneering insistence on *tacit knowledge* has provided a deep and extensive illustration of this aspect.

It may be useful, at this point, for a better comprehension of the proposed revision of market dynamics, to work out a more extensive critique of some important aspects of the existing economic systems and ideologies, in the light of this very model.

If, as in the capitalist order, the distribution of income between labour and capital is the result of the clash between wage earners and firms, unemployment cannot be eradicated. For employers, to counter unions and working people's demands, do, in fact, use the infallible weapon of unemployment. If profits are low or firms incur losses, dismissals rise to crush labour's pretensions. And in dynamic economies, firms may also try, with the help of technical progress, to save on labour where it causes rigidities. It is senseless to found protection of labour on laws, norms and rules that oppose the mobility of labour: indeed, such legislation is one of the key impediments to the increase in employment.

It seems clear that the establishment of a fully flexible labour market, which is indispensable in modern dynamic economy, *requires the abolition of wages set at the company and collective bargaining level.* This is all the more urgent in that ordinary collective bargaining does cause inefficiencies in the use of labour and make unemployment physiological. Uniformity of national wage agreements and some other rigidities swell the underground economy in the areas where labour productivity is too low for the national wage rate. These illegal activities allow a fierce exploitation of workers, who have no protection whatever. And the worst of it is that this underground economy is often the only alternative to unemployment.

Trade unions must seriously consider the severe restraints on their bargaining power. They may win as long as the claims of labour lubricate the entrepreneurial system, as wages, increasing in step with productivity gains, stimulate consumption, hence sales, and

eventually lead to an improvement in the condition of the working in the name of social peace and efficiency. But as soon as profits fall, unions find it impossible to force employers to pay higher wages. In substance, the game of wage bargaining is always dominated by the employers, who are most often propelled by competition, avidity and unscrupulous behaviour. It is surprising that trade unions, whose function is to defend labour, have not understood that the root of exploitation is the institution of wage labour itself. It is a misfortune that the distribution of income is so largely determined by wage earnings.

Conflict between labour and capital over wage rates is the worst possible method of income distribution and works as a powerful obstacle to production. The task of firms is to produce material wealth and create jobs. They should be able to do so without being plagued by the perennial conflict with labour, which may be seen as an inappropriate social conflict since it takes place in the wrong place. Income policies to remedy the conflict demonstrate the failure of the company wage approach. They are a rather tortuous way of establishing some kind of income distribution more rational than that implied by the "labour market". *It is crucial to bring income distribution outside the firm, as far as this is possible. This is indispensable to full employment and company efficiency consistent with social justice and individual autonomy. Trade unions should oversee health and safety at the work place. They should fight for the distribution of the fund of common wealth, but not for the company wage.*

Let me also point out that the idea of the workers' self-management[18] of the firm is mistaken. And the

[18] Where «workers have control over the production process in the enterprise in which they work, since they have ultimate authority, one-person, one-vote, on the enterprise itself» See

workers' remuneration based on firms' results is a vehicle of inequalities and managerial degeneracies. Firms must be managed by entrepreneurs, and must not be involved in the struggle over income distribution. Entrepreneurs' ability in decision-making and innovating must not be constrained by the decision-power of incompetent persons. The entrepreneur must be responsible in terms of results, i.e. profit rate, not subjected to the command of a non-entrepreneurial body. Besides, the rational organization of the economy requires that firms pay for the resources they utilize, including labour, at prices determined by supply and demand. This is a fundamental rule of efficiency, indispensable both to rational use of the resources available and to defeating unemployment. Income distribution is a totally different matter, one that concerns society as a whole. The usual forms of wage bargaining obstruct efficient utilization of resources and prevent far-seeing policies of distribution of wealth. Such bargaining is the product of spontaneous evolution, a sort of "primitive" organizational form of society. An advanced society should be able to supplant those institutions with better thought-out organizational forms.

Moreover, the strict link between the production and distribution of income -or, more precisely, the fact that the distributive conflict affects business accounts, seriously undermines the firms' investment, as well as economic growth and employment. Aggregate investment must be determined by the community and as part of the process of income distribution. This aspect will be clarified by discussing how firms should be financed.

In conclusion, it should be clear that income distribution concerns the entire society and that even

D. Schweickart, in *Market Socialism* (1998), edited by B. Ollman, Routledge, New York and London, p. 127.

production is a social entity since it depends on productive forces engendered by society, such as techniques and knowledge. Some ingenuous theories of exchange value have long maintained that there is an unbreakable connection between income production and distribution. But no such connection exists, except the part due to incentives and the fact that income distribution influences production through the propensity to consume.

In particular, it is senseless to attribute to exchange value an ethic-ideological content as, for instance, the labour-value theory does. The statement value=labour makes some sense only in a stationary economy. In an economy based on innovation, wealth is, for a large part, a result of creativity, genius, and of the entrepreneurial search and intuition. Price is, therefore, a completely different thing from labour-value, and there is no bridge between the two. Really, exchange value displays only the mere functional price role. Precisely, it acts as an indicator of productive opportunities and relative abundance, and as a means to make homogeneous a multiplicity of commodities physically different from each other; its role is thus to facilitate comparison and exchange among these goods. So the ethic and ideological flavour of the labour-value hypothesis, with its implications on income distribution, expresses not only a limiting but also a senseless formulation of the much wider ethical and ideological problem.

The organization of production, distribution and exchange as discussed here attributes a social content both to income production and to distribution. Moralists and social reformers have always considered the market a gymnasium for corruption and aggressiveness, a place of violent contrasts among men, an open space for selfishness and fraud; in brief, it's been depicted as one of the worst instruments of domination, oppression and exploitation of man by man. But we have seen that the market can be shorn of these unpleasant attributes and transformed into a mere mechanism for the imputation of costs and the stimulus to efficiency through prices, which serve to signal the availability of each commodity. We have also seen that the market mechanism, aided by competition, and combined with a profit rate as an indicator of success (which, as such, allows accountability) can be a highly effective mechanism for stimulating efficient decision- making and management in the absence of monopolistic privileges and under the clear and inescapable rule of law (designed to prevent bribes and other abuses). *The disconnection of the market mechanism from the struggle for income distribution makes for efficiency, individual initiative and social justice, and may thus be relied upon to turn selfishness into healthy rivalry.*

6. Interest Rate, Production Financing and Effective Demand

A reformist agenda aimed at the overhaul (if not the transformation) of the capitalist economy would be clearly incomplete without a critique of the most capitalist trait of all: the rate of interest and the rhythm of financial capital. By clarifying the nature of these instruments' role, we will open to the door to a reform of the process of capital accumulation and of the system of corporate finance.

The rate of interest has been considered, in the course of history, as an unjust appropriation of revenue by capital owners. The dispute on its permissibility reached a paroxysm in the Medieval age–in times marked by the florescence of mercantile activity—and was mainly driven by the conflict that arose between Christian ethics and the business drift. The phenomenon of interest continued to loom largely throughout the turbulent transition that led to the advent of the modern

world: and the tragic irony is that this turbulent episode, from an organizational point of view, turned out to be a gigantic, sad waste of life and time, as shall be seen hereafter.

The suspicion of there being foul play and manipulation behind the eternal vicissitudes of monetary dynamics seems corroborated by the spasmodic variability of the rate of interest in the course of history; rates always appear painfully high within societies chronically afflicted by misery and stagnant production. Homer has dedicated a ponderous study to the history of interest rates.[19] The first development of banking, in Medieval Italy, acted like a brake on the surge of interest rates, which indeed fell in this country to levels between 10 and 20 per cent, while in the British isles and Germany they shot to levels as high as 100 per cent. In the late fourteenth century, Italian interest rates on commercial loans hovered around 8 per cent, with a minimum of 5 per cent, and in the fifteenth century an average of 5 per cent prevailed in Germany. A century later, interest rates between 4 and 12 per cent were frequent in Italy, Antwerp and Lyons. The historian C. Cipolla has documented that the Genoa's financial powerhouse, the Banco of San Giorgio, charged interest and discount rates of 5 per cent in the fifteenth century and little above 1 per cent a century late[20]. The wars of the sixteenth and seventeenth centuries caused a rise of the rates, but the seventeenth witnessed a new fall: in the Netherlands interests reached 4 per cent and, by the end of the century, 3 per cent. The incessant development of the banking system was the main cause of these decreases. With the advent of the financial leadership of England, in the eighteenth century, long term government bond yields declined in that country

[19] See S. Homer (1996)
[20] See C. M. Cipolla (1980)

towards 3 per cent and the usury laws reduced the maximum rate of interest to 5 per cent. In the nineteenth century, Britain's long-term interest rates stabilized at around 3 per cent, while government bond yields reached 2 per cent by the end of the century. The wars that followed caused the rates to rise again.

This course of business shows an inverse correlation between prosperity and interest rates; contrary to Homer's opinion, it does not give the causal direction of the two phenomena; but the association of these is meaningful. True, low levels of interest stimulate growth, and they often stand thereby as an expression of prosperity. What is more important, however, is that since interest rates decrease with the development of banking, their level and their very existence come indeed to depend on the characteristics of the credit system itself.

It is worthwhile to emphasize that interest basically represents a deduction from profit; and it may partially be discharged at the expense of wages, which is a sure way of exacerbating social conflict. In any case, interest stifles entrepreneurial initiative. Can such an impediment to entrepreneurship be eliminated? Can the ensuing deduction from labour-income be eliminated? Complex issue–marred by a host of misconceptions.

To begin, problematic is the moralists' and the political economists' insistence (from Aquinas to Marx) on denying interest on the basis of the labour theory of value[21] –a theory whose ultimate purpose seemed in fact that of shielding the exaction of interest. As set out earlier, such a theory is senseless. Therefore, the alternative justification for the rate of interest as the just

[21] In the *Tabula Exemplorum*, a manuscript of the thirteenth century, it is written: «All men abstain from working in Sunday days, but usurer ones work incessantly», See J. Le Goff, *La borsa e la vita*, Laterza, Bari 1987, p. 24

fruit (reward) of capital productivity –indispensable to the equilibrium between the supply and demand of capital—could easily gain ground (as in Neoclassical and Austrian theories). But that justification is contradicted by a simple remark: capital productivity needs technical progress,[22] which, for its part, has almost nothing to do with financial capital. Afterwards, the Sraffian discovery of the phenomenon of the 're-switch of techniques' (that is the possibility that a rise in the rate of interest may imply an increase in the intensity of capital, instead of a decrease), undermined the thesis of Böhm-Bawerk's average period of production, finishing off once and for all the fashionable models of capital productivity built upon Robinson Crusoe's utopia.

There exists a reasoning capable of solving the debate on interest and usury at once. We ask: is interest strictly necessary for productive and organizational efficiency? If it is not, the existence (and exaction) of interest is unnecessary, and we may thus safely conclude that interest represents an arbitrary and artificial form of income pocketed by the financial cartel. Is this the case?

Tily has written: 'If there is no necessary limit to the volume of credit/debt that can be created then it is essentially a free good. A rate of interest is a price, and prices are paid for scarce resources…. Interest becomes a social construct, to be manipulated according to the mandate, principles or interests of a country's authorities'.[23].

I argue that we need an argument somewhat more stringent in this regard.

Interest has not much to do with the equilibrium between supply and demand of capital. As a matter of

[22] In the absence of technical progress, the accumulation process would push capital productivity toward zero.
[23] See G. Tily (2004), pp. 8 and 13.

fact, far more than on interest, saving depends on the amount of income gained and therefore on the level of production. And, on the other hand, the entrepreneurs' demand for capital depends on entrepreneurship and the state of business, which is mainly expressed by profit expectations. The argument that the rate of interest is necessary in order to prevent 'over-investment' and the concomitant waste of capital is belied by the fact that such a role is *as a rule fulfilled not by the interest rate but by profit rate*, that is by (1) the entrepreneurial search for profit—i.e., the tendency to extract the highest rate of profit from investment—, and (2) by the gauge of accountability role of the profit rate (as discussed in section 3). All of the foregoing implies that the role of interest is simply to throttle entrepreneurship and to subtract income from distribution. It is, therefore, evident that, in principle, the share of income to be invested may be determined by the community abstracting from interest, and that, being the profit rate sufficient to impose a judicious use of capital, it is perfectly possible and efficient to share financing among the entrepreneurs at zero interest. *In sum, there are no technical impediments to the abolition of interest rate through legal prohibition, i.e. by defining as usurious a positive real interest rate.*

Of course, within of a free international financial market, there would need to be a concerted agreement to abolish interest everywhere across the world. However, zero percent might encourage the tendency to hoard money; but this could be opposed through a low rate of inflation or some sort of Gesellian demurrage scheme on cash money. At any rate, nowadays the tendency to hoard seems to be almost irrelevant, since the variety of modern banking services manages to keep private consumption flowing in a perennial, and tumultuous flow. It is indeed remarkable that on the shoulders of a variable, as unnecessary, if not wholly

pernicious, as the interest rate, has grown an enormous, complicated and rather obscure economic body mainly devoted to speculation and entirely responsible for all the serious shocks and malfunctions of the global network.

There remains, at this point, to try to delineate a blueprint for a financing system of production shorn of the negative and pervasive presence of interest –a blueprint capable, among other things, of clipping the wings of financial capital, stimulating entrepreneurship and contrasting the deficiency of global demand-. A discussion on the procedures to modify the banking system in accordance to what will follow is not relevant in this context, and a detailed analysis of the tricks and abuses of that system may form the theme of another paper. The important point is, at this juncture, to stress that the central function of the banking system, when it comes to fund production, needs to be radically modified. Financial capital was born not to serve production but to enslave it, and exploit the toiling community into the bargain. This distortion needs to be redressed at once. My proposal, born as a reaction against the undue appropriation of wealth perpetrated by the financial oligarchy, is presented here in a fashion as simple and transparent as possible.

Every year the community should define the share of value added to assign to consumption and investment, and to investment in selected strategic sectors. After that, care must be taken to ensure, through stimulus and instructions to the banking system, that these prescriptions are executed, as each investment is at the discretion of the businesses.

The capital required by the firms will come, in the first place, from profits. The uninvested portion of a firm's profits may be set aside for future investment. But the financing of capital must generally exceed the reinvested profits, so as to allow the formation of new firms and the financing of the firms' investment plans in excess of gross profit. Such extra accumulation may be covered in part by private saving, which should yield a real interest rate of zero percent.[24] But savers should not be allowed to buy shares directly, since the stock exchange is much worse than a gambling house, as we shall shown in the next section. The rest of the funds required to achieve the planned rate of accumulation will be provided by the fund of common wealth, which should channel the residual quota to the banking system, to be distributed among firms.

Each bank's application to the fund for resources should be judged on the basis of the profit rate. In fact, bankers must be obliged to operate as entrepreneurs, and their commercial tenure must depend on business results. The more successful they are, as expressed by the profit rate, the more capital will be granted by the fund of common wealth via their commercial bank. Banks' profits should derive from the prices of the services that they offer to their customers; competition should keep these prices low.

A substantial feature of such a reform would be the creation of a mechanism directed to the achievement, through the firms' investment, of the yearly rate of accumulation projected by the community, so that to avoiding or reducing substantially the possibility of a deficiency of global demand. It would also act as a stimulus to entrepreneurship. A major condition for the effectiveness of the mechanism is that *bankers provide sufficient credit to firms to achieve the community's projected accumulation rate.* Therefore, if the banks' requests for capital do not exhaust the fund set aside for accumulation, the difference should be assigned compulsorily to banks (say in proportion to the amount each has requested), for distribution among investing firms. This implies that, if the propensity to invest is low, banks will be forced to lower the prices for their services so that all the funds allotted to them for investment may be placed with the applicant firms. Vice versa, if the amount of capital provided by the fund of common wealth is lower than the total applications of banks based on the firms' borrowing, the negative difference will be deducted from those requests, in inverse proportion to their profit rates. This guideline of equality between the allocations for saving and investment is of crucial importance for the control of aggregate demand; in particular, it moderates the cyclical effects of entrepreneurial euphoria or pessimism. Moreover, it stimulates entrepreneurship since, when demand for credit is slack, firms may obtain inexpensive loans, as banks are required to loan funds up to the accumulation target. So banks are induced to make golden bridges to entrepreneurship, as it were.

If the propensity to invest is low, the duty to attain the established aggregate rate of accumulation may cause heavy losses to the banking system. But this does not represent a problem for public firms, for which the profit rate is only an indicator of success; in fact, the relative degree of success may also be expressed by the inverse of the rate of loss.

7. On the International Economic Order

On the international plane, the absurdities of capitalism – and the urgency of a remedy therefor- appear even more starkly than do as when contemplated from the national angle. In fact, the growing integration of world markets, which has given rise to the global

[24] A real interest rate of 0 per cent on saving would actually be a bargain for savers. These in the course of time have generally suffered a continuous devaluation of their savings owing to inflation, fraud and robbery, which in turn are mainly caused by speculation on financial markets.

society, multiplies the distortions, opacity and larceny so characteristic of the “free market”. Speculation shifts enormous masses of capital instantaneously around the world. There isn’t any supranational authority deputed to discipline these activities or prevent the crises provoked by such massive transfers of ‘hot money’. Some codes of conduct have been devised as remedies, but unfortunately speculators are clever in crafting tricks to elude them. Moreover, the evolution of financial instruments and markets systematically makes these guidelines obsolete. In effect, it is most difficult to obtain reliable information and craft control instruments in a sphere dominated by uncertainty and rapid change to an extraordinary degree. As a consequence, the concentration of enormous wealth in private hands enables the holders to carry out gigantic frauds, e.g. the sale or dismemberment of healthy concerns at very low prices through manufactured crises. Public ownership of large companies and the model of accumulation set out above would greatly facilitate the exertion of controls and impede speculation.

It is most desirable to deter or prevent savers from engaging themselves in speculation in a landscape full of snares like the international capital markets. Firms should also be discouraged from dabbling in speculation, which distorts and denatures the imperatives of production and the accountability role of the profit rate.

The vices of the international market are aggravated by the selfish myopia of international economic institutions –those institutionally appointed to aiding countries in economic difficulty, usually the less developed economies. The so-called Washington Consensus hinges on three recommendations: privatisation, austerity and openness to the international market. But it is short-sighted as well as cynical to require that, to get aid, the less developed countries must enact policies to balance the budget, put their

international accounts back in order, open up the international goods and capital market, and proceed to privatise all that is public. Macroeconomic stabilisation centering on monetary and fiscal restrictions, which free-trade and the free capital market make particularly harsh, yields high interest rates and the contraction of demand, both of which throttle entrepreneurship and force large-scale bankruptcy. All this reduces output and employment, and increases the share of the population dependent on welfare. The disaster is completed by usurious interest rates on short-term loans, which must be complemented by reserve funds yielding much lower interest rates. During the 1997 crisis in East Asia, the IMF ratcheted up its rate by 25 points: a real disaster for production. Again, it is disheartening to see how interest, a variable that is technically useless, comes to play such an important and destructive role. Significantly, an economist well versed in the operation of international economic institutions like Stiglitz, has harshly criticized those policies.[25] These avoid the true problem, i.e. rebuilding the economy by stimulating efficiency and a sense of duty predicated on a system of clear responsibilities. The promotion of entrepreneurship, and public entrepreneurship in particular, is ignored, while privatisations are often nothing but the theft of public capital. In the recent past, various underdeveloped countries have tried to stimulate economic growth by promoting state industries through central planning. The failure of those efforts opened the door to privatisation. Many State industries in Russia ended up in private hand almost for nothing, even when they could have operated efficiently as public firms, had they been subjected to the accountability of the profit rate and the associated restructuring process.

[25] See J. E. Stiglitz (2002).

The policies enforced by the international institutions have had disastrous effects in the underdeveloped countries, where an entrepreneurial spirit is generally lacking and the ruling class is much more prone to dissipation, robbery and oppression than to production and innovation. With their systems of patronage and clientele they have perpetuated a corrupt power structure and condemned their masses to hunger.

Production should not be stifled by the class conflict over distribution. It should not be disturbed by the bitterness, the agitation and the despair of underdeveloped countries, or be troubled by unrestrained speculation, mainly to the detriment of working people. International institutions should not offer aid to keep big speculators from going bankrupt. Instead, they should ask, as a condition for aid: systems of accountability based on well-defined criteria of success and, in synthesis, the creation of an efficient, transparent system of economic power capable of production and administration, in lieu of governments dominated by adventurers, arrogant dictatorships, or confusing systems of law that only encourage abuse.

8. Conclusion

One of the chief economic problems of the West has been its increasing reliance on a strange sense of sublimated superiority, which it has erroneously imputed to the most proximate origin of its wealth: the capitalist market. The inference is mistaken in that the source of this wealth, whatever the merits and demerits of its nature and uses, lies in human ingenuity rather than in the capitalist machine, whose essentially constrictive and feudal countenance has come, fraudulently, to represent western economy as a whole. But capitalism is not western inventiveness as a whole; it is but a proprietary scheme that has usurped all the fruits of

western creation. And this tragic qui pro quo, has led the West to clash violently with the rest of the world. In truth, the capitalist system is the source of so many disadvantages to the westerners themselves: namely, social injustice, poisoned labour relations and the threat to human dignity, social and geographical disequilibria, the wideness of fluctuations, the sorceries and distortions promoted by the hegemony of finance capital, and finally the smothering of entrepreneurship, freedom and growth.

The present essay has attempted to show a possible way to remedy these ills, in particular the pervasive and distorting influence of the current market and financial systems. Our aim was to devise a model that couples efficiency with social justice, structural consistency with innovation; a system able to eliminate speculation and unnecessary (if not senseless) strife, while preserving the conflicts implicit in the very functioning of a dynamic society, such as the battle between innovators and conservatives. And we have shown that a proper functioning of the market is not inconsistent with man’s noble propensities, and that it may very well reduce fraud and greed.

The necessary set of conditions to achieve this goal consists of: 1) the reduction of the market to a mere mechanism for imputation of costs and of efficiency, 2) an expansion of the sphere in which public firms are allowed to operate within the market, 3) and a drastic reform of the banking system. More in particular, we have dwelled on: the essential role of the profit rate as an instrument of accountability for all concerns (public and private); the means of re-building a non-capitalistic economic body with a free market; and a model of capital accumulation able to stimulate entrepreneurship, and to achieve the aggregate accumulation rate –a rate to be set by the community, with a view to eliminating the tumorous growth of overheard and interest charges and the volatile disasters of finance capital.

The final section on the international market and disequilibria, wrought by the devilries of international finance, is but a beckoning call to drift toward a different conception of market economics, and a simpler and more transparent financial system than the dominant one, which is largely ridden by speculation, the concentration of power and the exploitation of the weak.

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Coalition Governments: Fiscal Implication for the Indian Economy

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Abstract

The Indian polity has been through 43 coalition governments at the state level between 1966/67 and 1998/99. In the present study we attempt to examine what this change in form of government from single party to coalitions has meant for the economy. The results of our study which examines the post 1980 period give us reason to be optimistic. Coalitions at the state government level appear to have, on an average, done well to increase capital expenditures particularly capital expenditures on social services and other developmental categories. They have, however, not succeeded in taking politically hard decisions of curbing revenue expenditures and revenue deficits. It is our contention that the weak majority of coalition governments is their major strength. The tenuous hold of coalitions on power gives them a license for undertaking reforms. If the opportunity is taken to undertake the more 'politically difficult' reforms to prune revenue expenditures then the 'era of coalitions' would turn out to be a blessing in disguise for the Indian economy.

[♣] I wish to thank Professor Ajit Karnik for his valuable comments and suggestions. I would also like to record my thanks to an anonymous referee whose insightful comments have helped improve this paper considerably. The usual disclaimer applies.

American Review of Political Economy, Vol. 3(1), Pages 127-163. March 2005

Keywords: Coalitions; Governments; Fiscal Policy; Public Expenditure; Growth

JEL Codes: H10, H50, E62

1. Introduction

Economists working in the area of *Public Choice* or *New Political Economy* have sought to build bridges across the disciplines of economics and political science. Politico-economic modeling has developed significantly in the western world but is fast gaining popularity in the developing nations. In the Indian context there have been some initial attempts to formally model the impact of interest groups (Karnik and Lalvani, 1996, 1997) and political business cycles (Karnik 1990; Sen and Vaidya 1996; Lalvani 1997, 1999; Khemani, 2000). Yet another feature of the Indian polity which has caught the attention of researchers is the transition from 'one party dominant system' in the early years after independence when the Indian National Congress was omnipotent and omnipresent in all parts of the country in 1951 to the coalition form of gvernment in 1967. While the experience of coalition governments at the central government level goes back to 1977, at the level of state governments it dates back to 1967. In recent years more and more states seem to find that elections leave them with a fractured mandate thus necessitating political parties to form alliances due to electoral compulsions. Politicians across parties seem to feel that India has entered '*an era of coalitions*' and that '*coalition politics is here to stay'.*

In the present study we attempt to examine what this change in form of government from single party to coalitions has meant for the economy. Since there is considerable experience of coalition governments in many states of India, in this paper we make a preliminary attempt to formally model and capture the economic impact of coalition governments at the state government level. Section 2 of the paper discusses the issues related to party systems and their policy implications; Section 3 chronologically lists out the various coalition governments at the central government level and across the states of India; Section 4 elaborates on the empirical exercise carried out in the present study. Finally, Section 5 concludes.

2. Party System and Policy Implication

There are a number of features of party systems and party organization that are salient for the understanding of political behaviour and resulting policy outcomes but fragmentation and polarization have received sustained attention. Fragmented systems are characterized by many competing parties. Cohesive party systems have opposite characteristics: a small number of larger, more encompassing parties, typically with more stable organizational structures and basis of electoral support. Polarization is defined by the ideological distance among parties. In developing countries, however, parties cannot be placed on the same left-right dimension that has been the core of party systems in advanced countries.

Roubini and Sachs (1989) have listed out some of the reasons why coalition governments in parliamentary systems find it hard to balance the budget. Firstly, individual coalition partners in multi-party governments have distinct interests. A typical prisoner's dilemma situation is likely to arise with respect to budget cuts. While all the partners of a coalition will prefer budget cuts, each individual partner may have the incentive to protect its own share of the budget. The non-cooperative solution of no budget cuts is likely to arise. Secondly, each of the individual coalition partners has a veto against change. Even very small parties within a coalition are powerful by virtue of the power to break the government. Thirdly, enforcement mechanisms among coalition partners will often be very weak. Thus, Roubini and Sachs (1989) point out that distinct spending objectives of coalition members, veto powers over parts of the budget and an inability to make binding commitments with other coalition members are likely to result in prolonged and excessive budget deficits. Empirical testing of their model shows the political cohesion variable (0 for one party majority; 1 for coalition government with two partners; 2 for coalition government with three partners and 3 for minority government) to be significantly affecting the change in net debt/GDP ratio.

Similarly, Haggard and Kaufman (1995) argue that characteristics of the party system have predictable policy consequence and that fragmentation creates impediments for the co-ordination required to initiate and sustain policy changes. More cohesive systems, on the other hand, are more likely to generate stable electoral and legislative support for economic reform.

Empirical support for the thesis that weaker governments are associated with higher deficits was also obtained by Edin and Ohlsson (1991). Their conclusion, however, rests on the inclusion of minority governments. Perotti and Kontopoulos (1998) find the result vanishing when minority governments are excluded. This suggests that minority governments are unable to raise taxes because of the lack of political support. The result also suggests that the distinction between minority and majority (related to the strength of government) is different from the notion of fragmentation (related to number of decision makers). Perotti and Kontopoulos (1998) find that cabinet size and coalition size have disproportionate effect on transfers and especially wage government consumption, the two

expenditure items that are key factors in the success of fiscal consolidation.

Echeverri-Gent (1998) in his discussion on the reform process in India under various political regimes at the center speaks of how weak coalition and minority governments seem to have fared better than single party governments in India. He draws attention to the fact that the Rajiv Gandhi government, which came to power with a thumping majority of 77 per cent seats in the Lok Sabha in 1985 did not initiate any bold reforms. In contrast, Narasimha Rao's minority government and the United Front coalition government took many bold decisions and major reform measures were introduced under both, weak government of Narasimha Rao and the United Front coalition. This paradoxical situation may be explained by the fact that the strong government under Rajiv Gandhi had a large majority and hence dissidence of few members would not threaten the party's hold over the government. Thus the strongest opposition to some of the reform measures came from within the party. In contrast, Rao's minority government had such a tenuous hold over power that even a few defections would threaten to bring down the government. Losing power would have left all members of the incumbent party worse off. This simple logic holds good for coalition governments too, which were formed by parties coming together and forming alliances purely on account of electoral compulsions and those governments, which have come to power with a slim majority. *Fear of losing power could in fact be considered the biggest strength of a weak coalition*. A downfall of the government would be a loss to every member of the coalition. This strength of a weak coalition i.e. the fear of being out of government if the government fell is likely to allow economic reforms to be initiated and sustained.

The only study, which empirically examines coalition governments and their impact on the Indian economy is

Dutta (1996), who considers the impact of coalition politics on some fiscal variables for the period 1967 to 1993. His study concludes coalition governments have had an adverse impact on the fiscal situation in India. However, with the sample period now extendable to 1999 and with the experience of many more coalition governments, we decided to re-examine the issue and also consider the impact on some key components of expenditures too. Also, we wished to examine if the result of Dutta (1996) was robust to the introduction of control variables.

In section 3 of the study that follows, we chronologically trace out the different coalition governments that have been formed at both, the center and in the various states.

3. Chronology of Coalition Governments in India: Central and State governments

At the central government level the first coalition government that came to power was the Janata Party during 1977-79. This was a turning point in the history of coalitions in India. It brought for the first time a group of non-Congress parties to power at the Central government level. The *Janata Party* came into being when four major parties the *Jan Sangh*, *the Congress (O)*, the *Bharatiya Lok Dal* and *Socialist Party* came together to contest the election with a common symbol and manifesto. The *Janata Party* obtained 43.17 % votes and captured 295 out of 540 seats (i.e. 55.4%). This electoral victory was an outcome of the unity of opposition leaders and parties. Failure of the *Janata Party* coalition was caused by personality clashes, ideological differences and defections. Single party dominance re-appeared during 1980-89. But after the ninth general election of 1989 the situation changed dramatically in favour of coalition governments at the Central government level. First came the *National Front* Government (1989-90). This was followed by the thirteen day government of A.B. Vajpayee in May 1996. From June 1996 to April 1997 the *United Front* government under H.D. Deve Gowda assumed office. After withdrawal of support by *Congress (I)*, the *United Front* government under the leadership of I.K.Gujral remained in office from April 1997 to March 1998. Finally, despite many apprehensions, the BJP (*Bharatiya Janata Party*) led coalition has held on from March 1998 to date.

At the level of state governments the fourth general election of 1967 has been looked upon as a watershed year in Indian politics. Thus coalition politics at the state level came into existence ten years prior to its arrival at the level of Central government. The year 1967 marked the end of Congress domination and ushered in coalition governments in the states of Bihar, Kerala, Orissa, Punjab, Rajasthan, Uttar Pradesh and West Bengal. Since then various states of the Indian federation have experienced coalition governments at different times.

One of the many reasons, which led to the downfall of single party dominance was ‘*defection*’ or ‘*factionalism*’. The word ‘defection’ generally denotes ‘abandonment’. However, in politics an act of political defection is said to signify leaving a party and joining another, nt due to a party split but in quest of individual power or personal disillusionment. Defections are not typical to the Indian system alone. They have occurred time and again in British Parliamentary history and have been a feature of politics in Australia and New Zealand. In India, the first instance f defection dates way back to 1935. However, its magnitude has grown significantly since then. During the short period f March to December 1967 out of a total membership of 3447, 314 members i.e. 9% changed party affiliation. During 1957 to 1973 as many as 45 state governments were toppled with 2700 of defections in state legislatures (Fadia, 1984). A large number of defections occurred from the Congress between 1962 and 1966, a period of strain caused by two wars Indo-China and Indo-Pakistan, the death of prominent leaders like Pandit Nehru and Lal Bahadur Shastri and two severe droughts.

Besides defection, there have been other reasons of governments having changed between elections. On some occasions new chief ministers belonging to the same party have been appointed and on others Presidential Rule has been enforced in states. Article 356 of the Indian Constitution provides for imposition of Presidential Rule (PR) when there is a *'failure of Constitutional machinery in the State*'. The ambiguity of the expression '*if a situation has arisen in which the Government of the state cannot be carried on in accordance with the provision of the Constitution*' has led to the article's persistent misuse by all governments. The duration of Presidential Rule has varied from a few weeks to a few months. However, since the data set we are using is annual we take into consideration the financial year in which the Presidential Rule was initiated irrespective of its duration. The in-between election changes of government or chief ministers have not been listed out. In the exceptional case of two or three states where the incumbent government was removed from power within a week or so we have taken note of the new government that assumed office.

In the remaining part of this section we discuss the political scene in 14 major states of India. In Appendix I we list out the incumbent parties which formed the government, both single party and coalitions, in the 14 major states of India since 1967. The abbreviations and full names of the parties appear in the Appendix II.

Andhra Pradesh (AP):

The state of AP has had no experience of coalition governments. It has always voted in favour of single party governments. Till the mid 1980s the state of AP was a Congress stronghold. But with the 1985 election the Telugu Desam Party (TDP) has emerged as the favourite and won four of the five elections after 1985. This state experienced Presidential Rule for short durations in 1979/80; 1980/81;1981/82;1982/83;1990/91 and 1991/92.

Bihar (BIH):

Bihar was a traditional stronghold of the Congress. In the 1967 elections the Congress party suffered one of its major defeats in the state and a non-congress coalition was formed. This marked the beginning of coalition governments in Bihar. The period 1972 to 1989 saw single party governments once again come to power. The 1990 elections saw a return of coalition governments to the state of Bihar. This state has experienced Presidential Rule during some months of 1979/80; 1980/81; 1994/95; 1995/96 and 1998/99.

Gujarat (GUJ):

Gujarat has had only two experiences of coalition governments. First, in 1975 the Janata Front and the second in 1990, the Bharatiya Janata Party (BJP) - Jantata Dal combine. Presidential Rule has been imposed in Gujrat in 1971/72; 1972/73; 1973/74; 1974/75; 1975/76; 1976/77 and 1980/81.

Haryana (HAR):

The State of Haryana came into being on 1st November 1966. The 1967 elections witnessed a Congress victory with absolute majority. However, a week later the ministry collapsed and a coalition ministry under Rao Birendra Singh of the Vishal Haryana Party (VISH) was formed. Soon defections led to mid-term elections in 1968 where once again the Congress secured a majority. The other two experiences of coalitions in Haryana have been under Lok Dal and BJP in 1987 and the Haryana Vikas Party (HVP) - BJP in 1996.

Karnataka (KARN):

The state of Karnataka has not experienced coalition governments at all. The voter in Karnataka has opted for single party government over the years. Presidential Rule has, however, been imposed in the state in 1970/71;1971/72;1977/78; 1989/90;1990/91.

Kerala (KER):

The state of Kerala has had a long history of coalitions. The state with the highest literacy rate in India has chosen to have coalition governments. The two fronts, United Democratic Front (UDF) and the Left Democratic Front (LDF), have since 1977 been alternately voted into power. The high predictability of the results of Kerala's election makes this state a pollster's delight. Predicting election results in Kerala has become very simple. Presidential Rule has been imposed in 1970/71; 1979/80; 1981/82; 1982/83.

Madhya Pradesh (MP):

The state of MP experienced coalition politics for a short duration only. The 1967 elections brought the Congress to power with a majority. However, defections brought about the fall of this government. This resulted in to the state experiencing its first coalition ministry in July 1967. This coalition government lasted till march 1969. This was again followed by a Congress government till the next election in 1972. Ever since, single party governments have ruled the state. 1979/80 and 1980/81 are the years when Presidential Rule was imposed.

Maharashtra (MAHA):

Maharashtra has, by and large been a single party state. Although the United Front did form a coalition for a very brief period in 1967, its first proper coalition government was formed in 1978 under the Congress leadership. Subsequently, coalition politics has returned to the state only as late as 1995 when the Shiv Sena BJP coalition formed the government. The state has not had Presidential Rule being imposed at any time. Thus indicating that political party changes in the state of Maharashtra have been by and large peaceful transitions.

Orissa (OR):

Orissa had a taste of coalition governments as early as 1967 when the Swatantra Party, Janata Party and the Congress came together to form the government. The 1971 elections also led to the formation of a coalition government by the Swatantra Party, Utkal Congress, Jharkhand Party and 3 independents. Since then the state has opted for single party rule.

Punjab (PUN):

Coalition politics in Punjab made its appearance with the 1967 elections. In the 1972 election Congress returned with a clear majority. The 1977 election once again led to formation of a coalition government of the Akali Dal, Janata Party and Communist Party of India (M). Between 1980 and 1997 single party governments ruled the state. 1997 elections once again saw the return of coalition form of government by the Akali Dal-BJP combine. Presidential Rule has been imposed in the state in 1968/69; 1971/72 and 1979/80.

Rajasthan (RAJ):

The first and only experience of coalition in this state was after the 1990 election when the BJP-JD combine formed the government. Presidential Rule has been imposed in the state in 1966/67, 1967/68, 1973/74 and 1979/80.

Tamil Nadu (TN):

The state of Tamil Nadu has had two experiences of coalition governments, the first in 1980 when AIADMK, CPI and CPM joined hands and the second in 1991 when AIADMK and Congress formed a coalition. By and large the state has been under single party rule. Like Kerala, the political scenario in TN has been dominated by two parties and since the 1984 elections we find that consistently the two parties have alternately come to power. 1976/77, 1977/78 were the two years when Presidential Rule had been imposed.

Uttar Pradesh (UP):

UP too has had brief episodes of coalition governments. After the 1967 elections congress emerged as the single largest party but failed to get absolute majority. They did form the government but in just two months a United Front ministry was sworn in. The assembly was dissolved in February 1968. Short duration of Presidential Rule was followed by fresh elections in February 1969. After this short spell of coalitions in the late 1960s, this form of governance has emerged only with the 1993 elections when the SP-BJP combine formed the government. The 1996 elections have brought the BJP and allies to power.

West Bengal (WB):

The state of West Bengal has created history in the assembly election 2001 by electing the same Left Front coalition for the sixth time. This coalition has ruled the state for 24 years from 1977 onwards. It is a classic example of how stable coalition governments can be if ideology is the binding force. With the exception of the Left parties coalition in WB and Kerala all other coalitions in the various states have been guided by electoral compulsions. Presidential Rule has had to be imposed in the state of West Bengal in 1967/68, 1968/69, 1969/70, 1970/71 and 1971/72.

The table on the following page lists out the years when the various states experienced coalition governments. Details of the incumbent parties in the various states have been tabulated in Appendix II.

Table 1
Experience of Coalition Governments and Presidential Rule in States of India
(1967-1999)

STATE	Year of coalition government	Year when Presidential Rule was imposed
Andhra Pradesh	None	1979/80, 1980/81, 1981/82, 1982/83, 1990/91, 1991/92
Bihar	1967, 1969, 1995	1979/80, 1980/81,1994/95, 1995/96, 1998/99
Gujarat	1975, 1990	1971/72, 1972/73, 1973/74, 1974/75, 1975/76, 1976/77 1980/81
Haryana	1967, 1987, 1996	None
Karnataka	None	1970/71, 1971/72, 1977/78, 1989/90, 1990/91
Kerala	1967, 1970, 1977, 1980, 1982, 1987, 1991, 1996, 2001	1970/71, 1979/80, 1981/82, 1982/83
Madhya Pradesh	1967	1979/80, 1980/81
Maharashtra	1967, 1980, 1995, 1999	None
Orissa	1967, 1971	1981/82, 1994/95
Punjab	1967, 1977, 1997	1968/69, 1971/72, 1979/80
Rajasthan	1990	1966/67, 1967/68, 1973/74, 1979/80
Tamil Nadu	1980, 1991	1976/77, 1977/78
Uttar Pradesh	1967, 1993, 1996	1971/72, 1992/93, 1993/94
West Bengal	1967, 1969, 1971, 1972, 1977, 1980, 1982, 1987, 1991, 1996	1967/68, 1968/69, 1969/70, 1970/71, 1971/72

We find that while states like Andhra Pradesh and Karnataka have experienced no coalition governments,

others like West Bengal and Kerala have had coalition governments for most of the years. Other states lie between the two extremes and have experienced three to four coalition governments.

4. Methodology and Empirical Findings

In the present study we set out to examine the impact of the coalition form of government on various fiscal variables and on the per capita State Domestic Product (PCSDP). Since state governments in India have experienced coalition governments for a much longer time than the center, performance of coalition versus single party governments could be better discerned if the analysis is carried out at the level of state governments. Hence, for our sample we settled on 14 major states of India listed out in section 3 above. The time span that we chose to consider ranges from 1981/82 to 1998/99. In the period prior to this i.e. from 1967, when the first coalition came into existence, till 1980 only 16 coalition governments had taken charge across the 14 states. However, in the post 1980 period we have 27 coalition governments which have governed the 14 states of India. With greater experience of coalition governments in the post 1980 period we chose to let our sample of 14 states cover the period 1981/82 to 1998/99. For each of the models to be estimated we obtain Generalised Least Squares (GLS) estimates of pooled cross section time series models which have been corrected for *Cross-Sectional Hetroscedasticity, Cross–Sectional Correlation and Autococorrelation.* Such a model, which allows for cross-sectional correlation is most suited to problems, which have as cross-sectional units, geographical regions with arbitrarily drawn boundaries. Cross-sectional correlation would therefore be an appropriate assumption in the present context where the states of India are the cross-sectional units being considered (Kmenta 1990,Greene 2000).

The basic framework for this analysis is the generalised regression model:

$$y_{it} = \beta' x_{it} + \varepsilon_{it}$$

The classical regression model specifies

$E[\varepsilon_{it}] = 0$
$Var[\varepsilon_{it}] = \sigma^2$
$Cov[\varepsilon_{it}, \varepsilon_{js}] = 0$ if $t \neq s$ or $i \neq j$

If we relax the assumption of a fixed σ^2 and allow it to vary across i. This results in a groupwise hetroscedastic model.

The extension of the model for cross-sectional, or contemporaneous correlation is

$E[\varepsilon_i \varepsilon_j'] = \sigma_{ij} I$

Finally, we allow for autocorrelation within cross-sectional units. The pooled model that we estimate is of the form:

$$GOV_{it} = a_i + b_i X_{it} + b_{zi} Z_{it} + D_{it} + e_{it} \qquad \textbf{(1)}$$

Where,

GOV = measure of government expenditure or its components or the growth rate of per capita income.

X_{it} = vector of explanatory variables

Z_{it} = variable of interest viz. Type of Government
0 when single party government
1 when coalition government

D_{it} = intercept dummies for each cross-sectional unit.

e_{it} = random disturbance term

At this juncture we would like to draw attention to the fact that that we have assumed that the coalition government of West Bengal is a single party and not a coalition. The rationale for this being that West Bengal is the exceptional case where the leading party of the coalition, CPI(M), has always secured a clear majority of 51% seats on its own. (The 2001 election is the first time when the CPI(M) has fallen short of the 51% mark. However, the sample period of this study ranges from 1981/82 to 1998/99). Since the question we are asking is "does a tenuous hold over the government by a coalition cause coalition governments to perform better than single party governments ?" it would be incorrect to consider the West Bengal coalition (where the leading party has always secured a clear majority) on par with other coalitions which have a tenuous hold on the government.

The dependent variables that we chose to examine and the independent and control variables used in our estimation have been listed out and defined in the following table:

TABLE 2

Variable	*Definition*	*Expected signs to Vindicate Echiverri-Gent Hypothesis*
Dependent Variables		
PKOUT	Capital Outlay (in per capita terms)	$\frac{\partial PKOUT}{\partial COAL} \geq 0$
PDEK	Developmental Expenditures on capital account (in per capita terms)	$\frac{\partial PDEK}{\partial COAL} \geq 0$
PKSOC	Capital expenditure on social services (in per capita terms)	$\frac{\partial PKSOC}{\partial COAL} \geq 0$
PRX	Expenditure on Revenue account (in per capita terms)	$\frac{\partial PRX}{\partial COAL} \geq 0$
PRRC	Receipts on Revenue account (in per capita terms)	$\frac{\partial PRRC}{\partial COAL} \geq 0$
PRDEF	Revenue deficits (in per capita terms)	$\frac{\partial PRDEF}{\partial COAL} \geq 0$
KOUTY	Capital Outlay (as per cent of SDP)	$\frac{\partial KOUTY}{\partial COAL} \geq 0$
DEKY	Developmental Expenditures on capital account (as per cent of SDP)	$\frac{\partial DEKY}{\partial COAL} \geq 0$
KSOCY	Capital expenditure on social services (as per cent of SDP)	$\frac{\partial KSOCY}{\partial COAL} \geq 0$
RXY	Expenditure on Revenue account (as per cent of SDP)	$\frac{\partial RXY}{\partial COAL} \geq 0$
RRCY	Expenditure on Revenue account (as per cent of SDP)	$\frac{\partial RRCY}{\partial COAL} \geq 0$
RDEFY	Revenue deficits (as per cent of SDP)	$\frac{\partial RDEFY}{\partial COAL} \geq 0$
PCSDP	Per capita Net State Domestic Product	$\frac{\partial PCSDP}{\partial COAL} \geq 0$
Independent Variables		
COAL	1 during the years of coalition governments 0 otherwise	
PR	A dummy variable which takes on value 1 in the years when Presidential Rule was imposed in the states; 0 otherwise	
PRDEF1	Lagged per capita revenue deficits	
URPOP	Urban population/total population	
POV	Percentage of population in poverty	

The states of India vary significantly in terms of population size. A large state like Uttar Pradesh with a large population would definitely incur higher expenditures as compared to a state like Haryana, which has a much smaller population. In order to eliminate the effect of population size on expenditure and income levels in the different states of India, each of our variables in the model have been considered in per capita terms.

A pooled cross section time series analysis was carried out with 252 observation (14 states and 18 time periods for each state from 1981/82 to 1998/99). The models have been estimated without a constant term as intercept dummy variables have been included for each cross sectional unit. Inclusion of the constant term would cause us to fall into a dummy variable trap (see Gujarati, 1995).

To begin with we look at the capital side of the budget. Results obtained have been tabulated in Table 3 below:

TABLE 3

	Model 1	Model 2	Model 3
Dependent variables → / Independent variables ↓	PKOUT	PDEK	PKSOC
COAL	3.28** (9.01)	3.40** (10.25)	0.58** (11.73)
PR	-2.22** (-11.73)	-2.37** (-14.56)	-0.11** (-2.36)
POV	0.013** (4.04)	0.013** (4.58)	0.0037** (6.26)
URPOP	0.68** (32.41)	0.66** (39.07)	0.09** (17.38)
BUSE R^2	0.90	0.94	0.72

** Indicates significance at the 5% level

In model 1 above we find coalition governments (COAL) have a significantly positive impact on capital outlays. This result supports the Echeverri-Gent (1998) hypothesis that coalition governments, which have a tenuous hold on government are seen to perform better as compared to single parties which have a stronger hold on the government but are more prone to defections and opposition from within the party ranks. The dummy variable for Presidential Rule (PR), which represents a situation of political disarray, conforms to expectations and shows up with a negative and significant coefficient.

Among the economic control variables included in the model are proportion of urban population (URPOP) and percentage of population in poverty (POV). The positive and significant coefficient of URPOP conforms to our expectation thereby implying that capital expenditures increase with increasing demands for infrastructure, both physical and social, which arises on account of urbanization. The positive coefficient was also expected on account of the fact that increasing urbanization is associated with increasing pressure from interest groups, which vie with each other to channelize benefits in their favour. The allocation of government expenditures has been found to be susceptible to such pressures (Olson 1982, Bardhan 1984, Karnik and Lalvani 1997).

The poverty variable (POV) defined as percentage of population in poverty (POV) is used as a proxy measure to capture income inequality. A more precise measure would, undoubtedly, have been the Gini coefficient. However, the Gini coefficient is not available for at the state level after 1993/94. Since the sample period of our study extends to 1998/99 we were unable to use the Gini coefficient as our measure of inequality. Instead, we make use of the variable POV. The government in its distributive role is expected to enhance growth and reduce inequalities by incurring larger expenditures. The POV variable would therefore be expected to show up with a positive sign. The result obtained in model 1 conforms to expectations and POV appears in the model with a positive and significant coefficient.

The results obtained in model 1 for aggregate expenditures on capital account are almost replicated in model 2 with development expenditures on capital account (PDEK) as the dependent variables. Coalition governments are seen to have positive and significant effect on developmental expenditures on capital account. Presidential Rule has a negative and significant impact. POV and URPOP continue to maintain their sign and significance.

In model 3 we have per capita capital expenditure on social services (PKSOC) as the dependent variable. We find that coalition governments have had a positive and significant impact here too. The variable for Presidential Rule continues to show a negative sign. URPOP and POV are both positive and statistically significant.

The overall picture that emerges from an examination of the capital side of the budget is that coalition governments have had a positive impact. Undoubtedly, this result is counter-intuitive. It goes against the widely accepted reasoning that coalition politics is responsible for economic reforms not being pushed forward. The underlying assumption, of course, is that capital expenditures have a beneficial and positive impact on the economy.

Having found that coalition governments have performed better than single party governments on the capital side of the budget, we now turn our attention to the 'current' expenditures and receipts side of the budget. Current Expenditures and budgets are referred to revenue receipts and expenditures in the context of the Indian economy. Echeverri-Gent (1998) had suggested that fragmented governments like those in India are likely to undertake only those reforms, which increase economic resources and arouse less opposition. While capital expenditures are incurred on creation of capital assets, revenue expenditures comprise expenditures incurred on goods and services for current consumption. These expenditures are easily targeted to specific groups and hence are readily made use of by incumbent parties to enrich their vote bank. Large parts of it are spent on salaries of government employees. Increased expenditures on revenue account signal burgeoning government size and populist policies on the part of government. The Echeverri-Gent (1998) hypothesis therefore implies that coalition governments are unlikely to take 'politically hard' decisions like cuts in revenue expenditures. Results obtained for our study have been tabulated in Table 4 below:

TABLE 4

	Model 4	**Model 5**	**Model 6**
Dependent variables → / Independent variables ↓	**PRX**	**PRRC**	**PRDEF**
COAL	13.98** (23.60)	8.40** (10.48)	1.01** (4.62)
PR	-2.89** (-7.36)	-2.69** (-4.30)	-2.52** (-6.87)
PRDEF(-1)	-	-	0.083** (28.39)
POV	0.19** (21.46)	0.12** (7.08)	0.11** (15.28)
URPOP	5.54** (100.8)	4.96** (35.63)	0.25** (7.82)
BUSE R^2	0.99	0.95	0.95

** Indicates significance at the 5% level

Our empirical findings lend support to the Eicheverri-Gent (1998) hypothesis that coalition governments have been unsuccessful in taking 'politically hard' decisions about pruning revenue expenditures. In model 4, COAL is positive and significant. Revenue expenditures, which are by and large consumption expenditures, increased during coalition governments. Presidential Rule is negative and significant, suggesting all categories of expenditures have been curbed during turbulent periods of Presidential Rule. Control variables, POV and URPOP are positive and significant as was seen when the capital side of the budget was examined in Table 3 above.

Model 5 examines the impact of coalition governments on revenue receipts. COAL is positive and significant, suggesting coalition governments have fared well on the revenue front. Once again the Presidential Rule variable is negative and significant. POV and URPOP maintain positive and significant coefficients.

Model 6 examines the impact of coalition governments on revenue deficits[1]. The variable COAL has a positive and significant coefficient, which is in a way implicit in models 4 and 5. Though successful on the receipts front, runaway expenditures on the revenue account have meant coalition governments failed to keep revenue deficits under check. The dummy for Presidential Rule is negative and significant. A dynamic element is introduced via inclusion of lagged revenue deficits. This variable is positive and significant. POV and URPOP are both positive and significant.

In order to check if our results were sensitive to a change in specification of our models we performed sensitivity analysis by re-specifying our government size measures as ratios to State Domestic Product instead of in per capita terms. Results obtained for both the revenue and capital side of the budget are given below:

TABLE 5

	Model 7	**Model 8**	**Model 9**
Dependent variables →	**KOUTY**	**DEKY**	**KSOCY**
Independent variables ↓			
COAL	0.39^{-02}** (3.78)	0.35^{-02}** (3.27)	0.64^{-03}** (6.51)
PR	-0.25^{-02}** (-4.32)	-0.24^{-02}** (-4.38)	-0.30^{-03}** (-2.99)
POV	0.81^{-05} (0.68)	0.80^{-05} (0.67)	0.48^{-05}** (3.71)
URPOP	0.26^{-04} (0.55)	0.21^{-04} (0.45)	0.746^{-04}** (14.07)
BUSE R^2	0.87	0.91	0.81

** Indicates significance at the 5% level

[1] Revenue deficits are defined as the excess of revenue receipts (or current receipts) over revenue expenditure (current expenditures).

TABLE 6

	Model 10	**Model 11**	**Model 12**
Dependent variables →	*RXY*	**RRCY**	**RDEFY**
Independent variables ↓			
COAL	0.14^{-01}** (8.83)	0.99^{-02}** (2.56)	0.38^{-02}* (3.67)
PR	-0.13^{-02}** (-14.36)	-0.27^{-02} (-1.51)	-0.40^{-03}** (-3.99)
PRDEF(-1)	-	-	0.57** (15.71)
POV	0.58^{-03}** (12.13)	0.21^{-03}** (3.73)	-0.17^{-03}** (9.70)
URPOP	0.63^{-02}** (10.09)	0.21^{-02}** (3.79)	0.76^{-03}** (5.64)
BUSE R^2	0.95	0.85	0.83

** Indicates significance at the 5% level

Results obtained in Tables 5 and 6 above, with an alternative specification of our models corroborate the initial findings (Tables 3 and 4) that coalition governments have done well to increase expenditures on capital account but have failed to take the 'politically hard' decision of axing revenue expenditures. It thus appears that the findings of our study are fairly robust to a specification change. The control variables POV and URPOP continue to maintain their positive sign but lose their significance in models 7 and 8 above with capital outlay and development expenditures on capital account are examined. They are, positive and significant when the revenue side of the budget is looked at (Table 6).

As a final test of the performance of coalition governments as compared to that of single party governments we examine the impact of our coalition variable (COAL) on per capita State Domestic Product. The result obtained has been reported below:

$$PCSDP = \underset{(23.5)}{826.57COAL^{**}} - \underset{(-10.55)}{231.49PR^{**}} + \underset{(88.28)}{294.23URPOP^{**}} + \underset{(15.38)}{6.67POV^{**}}$$

BUSE R^2 = 0.99 (model 13)

Our primary variable of interest COAL is seen to take on a positive and significant coefficient. Thus coalition governments, which have been successful in raising capital expenditures (Tables 3 and 5) but have failed to curb revenue deficits (Tables 4 and 6), have on the whole succeeded on the income front. Coalition governments are seen to be associated with higher per capita State Domestic Product (model 13). The PR variable, as expected, continues to remain negative and significant. URPOP and POV, the control variables continue to maintain their positive sign and significance.

5. Conclusion

The Indian polity has been through 43 coalition governments at the state level between 1966/67 and 1998/99. With coalition politics having come to occupy the center stage of Indian politics, the time is opportune to examine if this change on the political front is likely to have an adverse impact on the economic front, as is generally believed. The results of our study give us reason to be optimistic. We find that there has been an increase in capital expenditures and in per capita State Domestic Product under coalition governments. However, political compulsions have prevented coalition governments from taking hard decisions of cutting down on revenue expenditures. Revenue expenditures by and large comprise current expenditures like salaries, subsidies etc. and do not add to capital assets. If the fiscal balance of state governments is to be improved upon, pruning of these burgeoning revenue expenditures, which are economically non-viable, will have to be undertaken.

The present study wishes to draw attention to the fact that the *weak majority* of *coalition governments is their major strength*. Since a downfall of the government would be a loss to every member of the coalition, the fear of losing power could in fact be considered the strength of a weak coalition. This tenuous hold of coalitions on power gives them the license for undertaking reforms. So far coalitions at the state government level seem to have, on an average, done well to increase capital expenditures particularly capital expenditures on social services and other developmental categories. Leading parties of coalition governments, both at the center and the states could take the opportunity to undertake some of the more 'politically difficult' reforms to prune revenue expenditures. If this does happen then the 'era of coalitions' would turn out to be a blessing in disguise for the Indian economy !

APPENDIX I

Table A1: Andhra Pradesh

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC	Single
1972	INC	Single
1978	INC	Single
1983	INC	Single
1985	TDP	Single
1989	INC	Single
1994	TDP	Single
1999	TDP	Single

Table A2: Bihar

Assembly Election year	Incumbent party/parties	Single/coalition
1967	United Front (SSP, PSP, JS, JKD, CPI)	Coalition
1969	INC, BKD, SD,HJD,JP, Swa. P, 6 indep.	Coalition
1972	INC	Single
1977	JP	Single
1980	INC	Single
1985	INC	Single
1990	JD+20 INDEP	Single
1995	JD, CPI, CPM, MCC (supp. by JMM(M) & JMM(S)	Coalition
2000	RJD-CONG	Coalition

Table A3: *Gujarat*

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC	Single
1972	INC	Single
1975	Janata Front (cong(o), JS, BLD, SP, indep 7)	Coalition
1980	INC	Single
1985	INC	Single
1990	BJP-JD	Coalition
1995	BJP	Single
1998	BJP	Single

Table A4: *Haryana*

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC After a week followed by a coalition under Rao Birendra Singh of VISH	Coalition
1968	INC	Single
1972	INC	Single
1977	JP	Single
1982	INC	Single
1987	Lok Dal(B)-BJP	Coalition
1991	INC	Single
1996	HVP-BJP	Coalition
2000	INLD	Single

Table A5: *Karnataka*

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC	Single
1972	INC	Single
1978	INC	Single
1983	JP	Single
1985	JP	Single
1989	INC	Single
1994	JD	Single
1999	INC	Single

Table A6: ***Kerala***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	United Front (CPM, CPI, SSP, RSP, KSP, ML)	Coalition
1970	CPI led coalition (outside support of congress)	Coalition
1977	UDF (congress led)	Coalition
1980	LDF (CPM led)	Coalition
1982	UDF (congress led)	Coalition
1987	LDF (CPM led)	Coalition
1991	UDF (congress led)	Coalition
1996	LDF (CPM led)	Coalition
2001	UDF (congress led)	Coalition

Table A7: ***Madhya Pradesh***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC /followed by UF/followed by INC	Single/ coalition/ Single
1972	INC	Single
1977	INC	Single
1980	JP	Single
1985	INC	Single
1990	INC	Single
1993	BJP	Single
1998	INC	Single

Table A8: ***Maharashtra***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC /followed by UF/followed by INC	Single/ coalition/ Single
1972	INC	Single
1978	INC	Single
1980	INC led coalition	Coalition
1985	INC	Single
1990	INC	Single
1995	SHS-BJP	Coalition
1999	INC-NCP	Coalition

Table A9: ***Orissa***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	Swantantra party, Janta Party and Congress	Coalition
1971	Swatantra Party, Utkal Congress, Jharkhand party and 3 indep.	Coalition
1974	INC	Single
1977	JP	Single
1980	INC	Single
1985	INC	Single
1990	JD	Single
1995	INC	Single
2000	BJD	Single

Table A10: ***Punjab***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	UF [AKD (tara singh), ADS, CPI(M), CPI , Jan sangh, Republican party, SSP, Indep.]	Coalition
1969	Akali Dal (sant)	Single
1972	INC	Single
1977	Akali dal-Janata Party-CPI(M)	Coalition
1980	INC	Single
1985	Akalis	Single
1992	INC	Single
1997	Akali Dal-BJP	Coalition

Table A11: ***Rajasthan***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC	Single
1972	INC	Single
1977	JP	Single
1980	INC	Single
1985	INC	Single
1990	BJP-JD	Coalition
1993	BJP	Single
1998	INC	Single

Table A12: ***Tamil Nadu***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	DMK	Single
1971	DMK	Single
1977	AIADMK	Single
1980	AIADMK-CPI-CPM	Coalition
1984	AIADMK	Single
1989	DMK	Single
1991	AIADMK-INC	Coalition
1996	DMK	Single
2001	AIADMK-INC	Coalition

Table A13: ***Uttar Pradesh***

Assembly Election year	Incumbent party/parties	Single/coalition
1967	INC /followed by UF coalition/	Single/ coalition
1969	INC	Single
1974	INC	Single
1977	JP	Single
1980	INC	Single
1985	INC	Single
1989	JD	Single
1991	BJP	Single
1993	SP-BSP	Coalition
1996	BJP and allies	Coalition

Table A14: *West Bengal*

Assembly Election year	Incumbent party/parties	Single/coalition
1967	UF	Coalition
1969	UF	Coalition
1971	Democratic Front	Coalition
1972	INC	Single
1977	CPI (M) led LF	Coalition
1980	CPI (M) led LF	Coalition
1982	CPI (M) led LF	Coalition
1987	CPI (M) led LF	Coalition
1991	CPI (M) led LF	Coalition
1996	CPI (M) led LF	Coalition
2001	CPI (M) led LF	Coalition

APPENDIX II

CODE	PARTY NAME
ADMK	Anna Dravida Munnetra Kazhagam
ADS	Akali dal (sant Fateh Singh group)
AKD (TARA sING)	Akali Dal (Master Tara Singh group)
BJP	Bharatiya Janata Party
BKD	Bharatiya Kranti Dal
BLD	Bharatiya Lok Dal (Janata Party)
BSP	Bahujan Samaj Party
CPI	Communist Party of India
CPI(M)	Communist Party of India (Marxist)
DMK	Dravida Munnetra Kazhagam
HJD	Hul Jharkhand Party
HVP	Haryana Vikas Party
INC	Indian National Congress
INCO	Indian National Congress (organised)
INCU	Indian National Congress Urs
INLD	Indian National Lok Dal
JD	Janata Dal
JHP	Jharkhand Party
JKD	Jana Kranti Dal
JMM(M)	Jharkhand Mukti Morcha
JMS	Jai Mahakali Nigrani Samiti
JP	Janata Party
JS	Jana Sangh
KSP	Kerala Socialist Party
LD (B)	Lok Dal (Bahuguna)
LDF	Left Democratic Front
LF	Left Front
ML	Muslim League
NCP	Nationalist Congress Party
PSP	Praja Socialist Party
RJD	Rashtriya Janata Dal
RSP	Revolutionary Socialist Party
SHD	Shoshit Dal
SP	Sarvodaya Party
SHS	Shiv Sena
SSP	Samyukta Socialist Party
SWA	Swatantra Party
TDP	Telugu Desam Party
UDF	United Democratic Front

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