Depression, its Cause and Cure

The news isn't so good these days. Major financial institutions are in serious trouble. Some have failed and their assets been taken over. The stock market has been fluctuating sharply. Various experts disagree regarding the magnitude of our current crisis. Some say that the fundamentals of our economy are sound, while others say we haven't had such a serious economic situation since the Great Depression of the 1930's.

Regardless of how one explains such events, and there have been many explanations, they all depend on and deal with one factor, money. There is talk of prices or debt or money supply but always the subject of the explanation is some relationship involving money. Whenever an economy is not doing well the subject of money will arise. But one question that is never asked and never answered is "Why are such troubles possible at all?" What is it about an economy such that with a lot of skilled people and many resources and many needs to be met, they sometimes stop working to produce things from those resources? After all, people will suffer from want because they need those products that are no longer being made. They become poor. None of these people want to stop working, and producing. None of these people want the situation in which they find themselves. No one wanted this to happen because it harms everyone, even the rich. And yet there it is. Different people have different ideas about how to solve the problem but for one reason or another, the problem seems to continue and get better or worse in its own time, uncontrolled by governments or businesses.

Let's try to answer that question of why such economic dislocations and disasters are possible in the first place. The first thing to notice is that the supply of a physical object money is *independent of the supply of goods and services for sale*. The supply of money can be quite volatile increasing rapidly (the usual thing) or decreasing rapidly which can be just as bad. Increasing the money supply by printing or coining more currency is one *obvious* way of increasing the money supply but it is not the *only* way at all. It is much more common for the supply of money to be changed by loans. When one loans money one increases the supply of money because the person who lends still owns the money and the person who borrows also can spend the same money. (Yes, I know that sounds silly but money *is* pretty silly in what it lets us do.) So if a bank has $100 in deposits and loans $50, there is $150 of money that can be spent. Thus when lots of people in an economy borrow lots of money from one another the supply of money can increase hugely. If they cannot pay it back (and there is never *really* enough money to pay back what is borrowed because of the interest) then the money is gone and neither the borrower nor the lender has the

money and the money supply shrinks. Okay, that is all pretty simple. So what's the problem?

Well the problem is that there are things in all economies which we can call <u>feedback loops</u>. For example, if Joe loses his job and stops having income, Joe can't spend as much money as before so there is less demand for goods since Joe isn't buying as much as before. That drop in demand means that Sam will be laid off since demand is down. Now Sam isn't spending either so Willy and Fred are laid off. This sort of thing can also work the other way, of course. Usually there are enough good and bad things happening for the economy at any one time that they sort of balance out. Things may be trending generally toward expansion or toward a little contraction but *generally* they are stable and trend to more production. However, *if there is a big enough change in the economic situation*, like lots of people not being able to pay their mortgage payments, the amount of feedback of one kind builds up a sort of momentum. Then a *lot* of people stop spending so a *lot* of people lose their jobs which results in *much* less spending. *This* feedback loop affects the loop those who make loans. With people losing their jobs, the lenders are less willing to loan money out since it is less likely to be repaid. The reduction in money for loans means that less money can be borrowed for general spending which again reduces demand and decreases employment. The increase in defaults on loans results in banks losing money since the value of the property they had accepted as collateral is now less than the amount of the loans that are not being repaid. So the money supply decreases even faster.

Why can this happen? Mostly because *the supply of money has little to do with the supply of goods and services for sale*. There are many other contributing factors but that is the single most important.

Why is this not possible in a non-<u>POM</u> economy? Because in such an economy the amount of money *is* a product of the amount of goods and services available for sale. In fact, the balance between the two is very close. If something is produced for sale, that amount of money comes into existence. If something is purchased, that amount of money ceases to exist. The balance is always maintained.

But beyond that, whenever one produces beneficial things, one gets paid for that benefit. One always has a money motive to produce since money *is* no object. One's very act of production increases the available money just as one's very act of consumption reduces the supply of money.

In a non-POM economy money *cannot be borrowed or lent*. There is no <u>credit</u>. To buy something one must have enough money to pay in full. But this doesn't reduce the demand for goods and services because there is plenty of money available to buy them all. There is no unemployment

because anyone can produce. There is a tacit agreement between the Payers and the producers that the Payers will pay any who produce net benefit. Thus all who desire to work are employed. The very idea of people not producing even though they want to work in a non-POM society is just laughable. In a non-POM society money is no object. If it is good for others there is money to pay for it, always.