Southey Favors Nationalization

In contrast, let us consider the *Quarterly Review*, a high Tory journal which always "assumed that the unreformed Parliament, the dominance of a landed aristocracy . . . the supremacy of the established church, discrimination of some sort against Dissenter, Catholic, and Jew, and the keeping of the lower classes in their place were the foundations of a stable society." Their leading writer on economic problems, the poet Robert Southey, repeatedly urged government expenditure as a stimulant to economic activity, and attacked England's resumption of specie payments (return to the gold standard) after the Napoleonic Wars. Indeed, Southey proclaimed that an increase in taxes or in the public debt was never a cause for alarm, since they "give a spur to the national industry, and call forth national energies." And, in 1816, Southey advocated a large public works program for relief of unemployment and depression.[11]

The *Quarterly Review*'s desire for stringent government control and even ownership of the railroads was at least frankly linked with its hatred of the benefits that railroads were bringing to the mass of the British population. Thus, where the classical liberals hailed the advent of railroads as bringing cheaper transportation and as thereby increasing the mobility of labor, the *Quarterly*'s John Croker denounced railroads as "rendering travel too cheap and easy—unsettling the habits of the poor, and tempting them to improvident migration."[12]

The arch-Tory, William Robinson, who often denounced his fellow Tories for compromising even slightly on such principles as high tariffs and no political rights for Catholics, wrote many pre-Keynesian articles, advocating inflation to stimulate production and employment, and denouncing the hard-money effects of the gold standard. And the Tory, Sir Archibald Alison, inveterate advocate of inflation who even ascribed the fall of the Roman Empire to a shortage of money, frankly admitted that it was the "agricultural class"

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[11]See Frank W. Fetter, "Economic Articles in the *Quarterly Review* and their Authors, 1809–52," *Journal of Political Economy* (February 1958): 48—51.

[12]Ibid., p. 62.

that had suffered from the lack of inflation since resumption of the gold standard.[13]

Controls Under Elizabeth

A few case studies will illustrate the nature of mercantilism, the reasons for mercantilist decrees, and some of the consequences that they brought to the economy.

One important part of mercantilist policy was wage controls. In the fourteenth century, the Black Death killed one-third of the laboring population of England, and naturally brought sharp advances in wage rates. Wage controls came in as wage-ceilings, in desperate attempts by the ruling classes to coerce wage rates below their market rates. And since the vast bulk of employed laborers were agricultural workers, this was clearly legislation for the benefit of the feudal landlords and to the detriment of the workers.

Textiles vs. Agriculture

The result was a persistent shortage of agricultural and other unskilled laborers for centuries, a shortage mitigated by the fact that the English government did not try to enforce the laws very rigorously. When Queen Elizabeth tried to enforce the wage controls strictly, the agricultural labor shortage was aggravated, and the landlords found their statutory privileges defeated by the more subtle laws of the market. Consequently, Elizabeth passed, in 1563, the famous Statute of Artificers, imposing comprehensive labor control.

Attempting to circumvent the shortage caused by previous interventions, the statute installed forced labor on the land. It provided that: (1) whoever had worked on the land until the age of 12 be compelled to remain there and not leave for work at any other trade; (2) all craftsmen, servants, and apprentices who had no great reputation in their fields be forced to harvest wheat; and (3) unemployed persons were compelled to work as agricultural laborers. In addition, the statute prohibited any worker from quitting his job

[13]See Frank W. Fetter, "Economic Articles in *Blackwood's Edinburgh Magazine*, and their Authors, 1817–1853," *Scottish Journal of Political Economy* (June 1960): 91–96.

unless he had a license proving that he had already been hired by another employer. And, furthermore, justices of the peace were ordered to set maximum wage rates, geared to changes in the cost of living.

The statute also acted to restrict the growth of the woolen textile industry; this benefited two groups: the landlords, who would no longer lose laborers to industry and suffer the pressure of paying higher wage rates, and the textile industry itself, which received the privilege of keeping out the competition of new firms or new craftsmen. The coerced immobility of labor, however, led to suffering for all workers, including textile craftsmen; and to remedy the latter, Queen Elizabeth imposed a minimum wage law for textile craftsmen, thundering all the while that the wicked clothing manufacturers were responsible for the craftsmen's plight. Fortunately, textile employers and workers persisted in agreeing on terms of employment below the artificially-set wage rate, and heavy textile unemployment did not yet arise.

Enforcing Bad Laws

The programs of wage controls could not cause undue dislocations until they were stringently enforced, and this came to pass under King James I, the first Stuart king of England. Upon assuming the throne in 1603, James decided to enforce the Elizabethan control program with great stringency, including extremely heavy penalties against employers. Rigorous enforcement was imposed on minimum wage controls for textile craftsmen, and on maximum wage decrees for agricultural laborers and servants.

The consequences were the inevitable result of tampering with the laws of the market: chronic severe unemployment throughout the textile industry, coupled with a chronic severe shortage of agricultural labor. Misery and discontent spread throughout the land. Citizens were fined for paying their servants more than ceiling wages, and servants fined for accepting the pay. James, and his son Charles I, decided to stem the tide of unemployment in textiles by compelling employers to remain in business even when they were losing money. But even though many employers were jailed for infractions, such Draconian measures could not keep the textile industry from depression, stagnation, and unemployment. Certainly the consequences of the policy of wage controls was one of the reasons for the overthrow of the Stuart tyranny in the mid-seventeenth century.

Mercantilist Practices in Colonial Massachusetts

The young colony of Massachusetts engaged in a great many mercantilist ventures, with invariably unfortunate results. One attempt was a comprehensive program of wage and price controls, which had to be abandoned by the 1640s. Another was a series of subsidies to try to create industries in the colony before they were economically viable, and therefore before they would be created on the free market. One example was iron manufacture. Early iron mines in America were small and located in coastal swamps ("bog iron"); and primarily manufactured, or "wrought," iron was made cheaply in local bloomeries, at an open hearth. The Massachusetts government decided, however, to force the creation of the more imposing—and far more expensive—indirect process of wrought iron manufacture at a blast furnace and forge. The Massachusetts legislature therefore decreed that any new iron mine must have a furnace and forge constructed near it within ten years of its discovery. Not content with this measure, the legislature in 1645 granted a new Company of Undertakers For An Iron Works In New England, a 21-year monopoly of all ironmaking in the colony. In addition, the legislature granted the company generous subsidies of timberland.

But despite these subsidies and privileges, as well as additional large grants of timberland from the town governments of Boston and Dorchester, the Company's venture failed dismally and almost immediately. The Company did its best to salvage its operations, but to no avail. A few years later, John Winthrop, Jr., the main promoter of the older venture, induced the authorities of New Haven colony to subsidize an iron manufacture of his at Stony River. From the governments of New Haven colony and New Haven township, Winthrop was granted a whole host of special subsidies: land grants, payment of all costs of building the furnace, a dam on the river, and the transportation of fuel. One of Winthrop's partners in the venture was the deputy-governor of the colony, Stephen Goodyear, who was thus able to use the power of government to grant himself substantial privileges. But again, economic law was not to be denied, and the ironworks proved to be another rapidly failing concern.

Debtors' Relief a Scheme to Aid the Rich

One of the most vigorously held tenets of the dominant neo-Marxist historians of America has been the view that inflation and debtors' relief were always measures of the "lower classes," the poor farmer-debtors and sometimes urban workers, engaging in a Marxian class struggle against conservative merchant-creditors. But a glance at the origins of debtors' relief and paper money in America easily shows the fallacy of this approach; inflation and debtors' relief were mercantilist measures, pursued for familiar mercantilist ends.

Debtors' relief began in the colonies, in Massachusetts in 1640. Massachusetts had experienced a sharp economic crisis in 1640, and the debtors turned immediately to special privilege from the government. Obediently, the legislature of Massachusetts passed the first of a series of debtors' relief laws in October, including a minimum-appraisal law to force creditors to accept insolvent debtors' property at an arbitrarily inflated assessment, and a legal-tender provision to compel creditors to accept payment in an inflated, fixed rate in the monetary media of the day: corn, cattle, or fish.

Further privileges to debtors were passed in 1642 and 1644, the latter permitting a debtor to escape foreclosure simply by leaving the colony. The most drastic proposal went to the amazing length of providing that the Massachusetts government assume all private debts that could not be paid! This plan was passed by the upper house, but defeated in the house of deputies.

The fact that this astounding bill was passed by the *upper* house—the council of magistrates—is evidence enough that this was not a proto-Marxian eruption of poor debtors. For this council was the ruling group of the colony, consisting of the wealthiest merchants and landowners. If not for historical myths, it should occasion no surprise that the biggest debtors were the wealthiest men of the colony, and that in the mercantilist era a drive for special privilege should have had typically mercantilist aims. On the other hand, it is also instructive that the more democratic and popularly responsible lower house was the one far more resistant to the debt relief program.

Paper Money Inflation

Massachusetts has the dubious distinction of having promulgated the first governmental paper money in the history of the Western world—indeed, in the history of the entire world outside of China. The fateful issue was made in 1690, to pay for a plunder expedition against French Canada that had failed drastically. But even before this, the leading men of the colony were busy proposing paper money schemes. The Rev. John Woodbridge, greatly influenced by William Potter's proposals for an inflationary land bank, proposed one of his own, as did Governor John Winthrop, Jr., of Connecticut. Captain John Blackwell proposed a land bank in 1686, the notes of which would be legal tender in the colony, and such wealthy leaders of the colony as Joseph Dudley, William Stoughton, and Wait Winthrop were prominently associated with the plan.

The most famous of the inflationary land-bank schemes was the Massachusetts Land Bank of 1740, which has generally been limned in neo-Marxist terms as the creation of the mass poor farmer-debtors over the opposition of wealthy merchant-creditors of Boston. In actuality, its founder, John Colman, was a prominent Boston merchant and real-estate speculator; and its other supporters had similar interests—as did the leading opponents, who were also Boston businessmen. The difference is that the advocates had generally been receivers of land grants from the Massachusetts government, and desired inflation to raise the value of their speculatively-held land claims.[14] Once again—a typically mercantilist project.

Keynes Wouldn't Learn

From just a brief excursion into mercantilist theory and practice, we may conclude that Lord Keynes might have come to regret his enthusiastic welcome to the mercantilists as his forbears. For they were his forbears indeed; and the precursors as well of the interventions, subsidies, regulations, grants of special privilege, and central planning of today. But in no way could they be considered as "progressives" or lovers of the common man; on the contrary, they were frank exponents of the Old Order of statism, hierarchy, landed oligarchy, and special privilege—that entire "Tory" regime against which *laissez-faire* liberalism and classical economics leveled their liberating "revolution" on behalf of the freedom and prosperity of all

[14]See the illuminating study by Dr. George Athan Billias, "The Massachusetts Land Bankers of 1740," *University of Maine Bulletin* (April 1959).

productive individuals in society, from the wealthiest to the humblest. Perhaps the modern world will learn the lesson that the contemporary drive for a new mercantilism may be just as profoundly "reactionary," as profoundly opposed to the freedom and prosperity of the individual, as its pre-nineteenth-century ancestor.

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Capitalism versus Statism

From the very first we run into grave problems with the term "capitalism." When we realize that the word was coined by capitalism's most famous enemy, Karl Marx, it is not surprising that a neutral or a pro-"capitalist" analyst might find the term lacking in precision. For capitalism tends to be a catchall, a portmanteau concept that Marxists apply to virtually every society on the face of the globe, with the exception of a few possible "feudalist" countries and the Communist nations (although, of course, the Chinese consider Yugoslavia and Russia "capitalist," while many Trotskyites would include China as well). Marxists, for example, consider India as a "capitalist" country, but India, hagridden by a vast an and monstrous network of restrictions, castes, state regulations, and monopoly privileges is about as far from free-market capitalism as can be imagined.[1]

If we are to keep the term "capitalism" at all, then, we must distinguish between "free-market capitalism" on the one hand, and "state capitalism" on the other. The two are as different as day and night in their nature and consequences. Free-market capitalism is a network of free and voluntary exchanges in which producers work,

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[1]For a view of India by free-market economists, see Peter T. Bauer, *United States Aid and Indian Economic Development* (Washington, D.C.: American Enterprise Association, 1959) and B.R. Shenoy, *Indian Planning and Economic Development* (Bombay and New York Asia Publishing House, 1963).

produce, and exchange their products for the products of others through prices voluntarily arrived at. State capitalism consists of one or more groups making use of the coercive apparatus of the government—the State—to accumulate capital for themselves by expropriating the production of others by force and violence.

Throughout history, states have existed as instruments for organized predation and exploitation. It doesn't much matter which group of people happen to gain control of the State at any given time, whether it be oriental despots, kings, landlords, privileged merchants, army officers, or Communist parties. The result is everywhere and always the coercive mulcting of the mass of the producers—in most centuries, of course, largely the peasantry—by a ruling class of dominant rulers and their hired professional bureaucracy. Generally, the State has its inception in naked banditry and conquest, after which the conquerors settle down among the subject population to exact permanent and continuing tribute in the form of "taxation" and to parcel out the land of the peasants in huge tracts to the conquering warlords, who then proceed to extract "rent." A modern paradigm is the Spanish conquest of Latin America, when the military conquest of the native Indian peasantry led to the parcelling out of Indian lands to the Spanish families, and the settling down of the Spaniards as a permanent ruling class over the native peasantry.

To make their rule permanent, the State rulers need to induce their subject masses to acquiesce in at least the legitimacy of their rule. For this purpose the State has always taken a corps of intellectuals to spin apologia for the wisdom and the necessity of the existing system. The apologia differ over the centuries; sometimes it is the priestcraft using mystery and ritual to tell the subjects that the king is divine and must be obeyed; sometimes it is Keynesian liberals using their own form of mystery to tell the public that government spending, however seemingly unproductive, helps everyone by raising the GNP and energizing the Keynesian "multiplier." But everywhere the purpose is the same—to justify the existing system of rule and exploitation to the subject population; and everywhere the means are the same—the State rulers sharing their rule and a portion of their booty with their intellectuals. In the nineteenth century the intellectuals, the "monarchical socialists" of the University of Berlin, proudly declared that their chief task was to serve as "the intellectual bodyguard of the House of Hohenzollern." This has always been the function of the court intellectuals, past and present—to serve as the intellectual bodyguard of their particular ruling class.

In a profound sense, the free market is the method and society "natural" to man; it can and does therefore arise "naturally" without an elaborate intellectual system to explain and defend it. The unlettered peasant knows in his heart the difference between hard work and production on the one hand, and predation and expropriation on the other. Unmolested then, there tends to grow up a society of agriculture and commerce where each man works at the task at which he is best suited in the conditions of the time, and then trades his product for the products of others. The peasant grows wheat and exchanges it for the salt of other producers or for the shoes of the local craftsman. If disputes arise over property or over contracts, the peasants and villagers take their problem to the wise men of the area, sometimes the elders of the tribe, to arbitrate their dispute.

There are numerous historical examples of the growth and development of such a purely free-market society. Two may be mentioned here. One is the fair at Champagne, that for hundreds of years in the Middle Ages was the major center of international trade in Europe. Seeing the importance of the fairs, the kings and barons left them unmolested, untaxed, and unregulated, and any disputes that arose at the fairs were settled in one of many competing, voluntary courts, maintained by church, nobles, and the merchants themselves. A more sweeping and lesser-known example is Celtic Ireland, which for a thousand years maintained a flourishing free-market society without a State. Ireland was finally conquered by the English State in the seventeenth century, but the statelessness of Ireland, the lack of a governmental channel to transmit and enforce the orders and dictates of the conquerors, delayed the conquest for centuries.[2]

The American colonies were blessed with a strain of individualist libertarian thought that managed to supersede Calvinist authoritarianism, a stream of thought inherited from the libertarian and

[2]In a similar way, the British in the late nineteenth century had a great deal of difficulty in establishing their rule over the stateless, free-market tribe of the Ibos of West Africa. On Ireland, see Joseph R. Peden, "Stateless Societies: Ancient Ireland," *The Libertarian Forum* (April 1971) and the references therein.

anti-statist radicals of the English revolution of the seventeenth century. These libertarian ideas were able to take firmer hold in the United States than in the mother country owing to the fact that the American colonies were largely free from the feudal land monopoly that ruled Britain.[3] But in addition to this ideology, the absence of effective central government in many of the colonies allowed the springing up of a "natural" and unselfconscious free-market society, devoid of any political government whatever. This was particularly true of three colonies. One was Albemarle, in what later became northeastern North Carolina, where no government existed for decades until the English Crown bestowed the mammoth Carolina land grant in 1663. Another, and more prominent example was Rhode Island, originally a series of anarchistic settlements founded by groups of refugees from the autocracy of Massachusetts Bay. Finally, a peculiar set of circumstances brought effective individualistic anarchism to Pennsylvania for about a decade in the 1680s and 1690s.[4]

While the purely free and *laissez-faire* society arises unselfconsciously where people are given free rein to exert their creative energies, statism has been the dominant principle throughout history. Where State despotism already exists, then liberty can only arise from a self-conscious ideological movement that wages a protracted struggle against statism, and reveals to the mass of the public the grave flaw in its acceptance of the propaganda of the ruling classes The role of this "revolutionary" movement is to mobilize the various ranks of the oppressed masses, and to desanctify and delegitimize the rule of the State in their eyes.

It is the glory of Western civilization that it was in Western Europe, in the seventeenth and eighteenth centuries, where, for the first time in history, a large-scale, determined, and at least partially successful self-conscious movement arose to liberate men from the

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[3]On the ideological inheritance from Britain, see Bernard Bailyn, *The Ideological Origins of the American Revolution* (Cambridge, Mass.: Harvard University Press, 1967).

[4]See Murray N. Rothbard, "Individualist Anarchism in the United States: The Origins," *Libertarian Analysis* (Winter, 1970): 14–28.

restrictive shackles of statism. As Western Europe became progressively enmeshed in a coercive web of feudal and guild restrictions, and of state monopolies and privileges with the king functioning as the feudal overlord, the liberating movement arose with the conscious aim of freeing the creative energies of the individual, of enabling a society of free men to replace the frozen repression of the old order. The Levellers and the Commonwealthmen and John Locke in England, the *philosophes* and the physiocrats in France, inaugurated the Modern Revolution in thought and action that finally culminated in the American and the French Revolutions of the late eighteenth century.

This Revolution was a movement on behalf of individual liberty, and all of its facets were essentially derivations from this fundamental axiom. In religion, the movement stressed separation of Church and State, in other words the end of theocratic tyranny and the advent of religious liberty. In foreign affairs, this was a revolution on behalf of international peace and the end to ceaseless wars on behalf of State conquest and glory to the ruling elite. Politically, it was a movement to divest the ruling class of its absolute power, to reduce the scope of government altogether and to put whatever government remained under the checks of democratic choice and frequent elections. Economically, the movement stressed the freeing of man's productive energies from governmental shackles, so that men could be allowed to work, invest, produce, and exchange where they wished. The famous cry to power was *laissez faire*: let us be, let us work, produce, trade, move from one jurisdiction or country to another. Let us live and work and produce unhampered by taxes, control, regulations, or monopoly privileges. Adam Smith and the classical economists were only the most economically specialized group of this broad liberating movement.

It was the partial success of this movement that freed the market economy and thereby gave rise to the Industrial Revolution, probably the most decisive and most liberating event of modern times. It was no accident that the Industrial Revolution in England emerged, not in guild-ridden and State-controlled London, but in the new industrial towns and areas that arose in the previously rural and therefore unregulated north of England. The Industrial Revolution could not come to France until the French Revolution freed the economy from the fetters of feudal landlordism and innumerable local restrictions on trade and production. The Industrial Revolution freed the masses of men from their abject poverty and hopelessness—a poverty aggravated by a growing population that could find no employment in the frozen economy of pre-industrial Europe. The Industrial Revolution, the achievement of free-market capitalism, meant a steady and rapid improvement in the living conditions and the quality of life for the broad masses of people, for workers and consumers alike, wherever the impact of the market was felt.

An undeveloped and sparsely populated area originally, America did not begin as the leading capitalist country. But after a century of independence it achieved this eminence, and why? *Not*, as the common myth has it, because of superior natural resources. The resources of Brazil, of Africa, of Asia, are at least as great. The difference came because of the relative freedom in the United States, because it was here that the free-market economy more than in any other country was allowed its head. We began free of a feudal or monopolizing landlord class, and we began with a strongly individualist ideology that permeated much of the population. Obviously, the market in the United States was never completely free or unhampered, but its relatively greater freedom (relative to other countries or centuries) resulted in the enormous release of productive energies, the massive capital equipment, and the unprecedentedly high standard of living that the mass of Americans not only enjoy but take blithely for granted. Living in the lap of a luxury that could not have been dreamed of by the wealthiest emperor of the past, we are all increasingly acting like the man who murdered the goose that laid the golden egg.

And so we have a mass of intellectuals who habitually sneer at "materialism" and "material values," who proclaim absurdly that we are living in a "post-scarcity age" that permits an unlimited cornucopia of production without requiring anyone to work or produce, who attack our undue affluence as somehow sinful in a perverse recreation of a new form of Puritanism. The idea that our capital machine is automatic and self-perpetuating, that whatever is done to it or not done for it does not matter because it will go on perpetually—this is the farmer blindly destroying the golden goose. Already we are beginning to suffer from the decay of capital equipment, from the restrictions and taxes and special privileges that have increasingly been imposed on the industrial machine in recent decades.

We are unfortunately making ever more relevant the dire warning of the Spanish philosopher Ortega y Gasset, who analyzed modern man as:

> finding himself in a world so excellent, technically and socially, he believes that it has been produced by nature, and never thinks of the personal efforts of highly-endowed individuals which the creation of this new world presupposed. Still less will he admit the notion that all these facilities still require the support of certain difficult human virtues, the least failure of which would cause the rapid disappearance of the whole magnificent edifice.

Ortega held the "mass man" to have one fundamental trait: "his radical ingratitude towards all that has made possible the ease of his existence." This ingratitude is the basic ingredient in the "psychology of the spoiled child." As Ortega declares:

> Heir to an ample and generous past . . . the new commonality has been spoiled by the world around it . . . the new masses find themselves in the presence of a prospect full of possibilities, and furthermore, quite secure, with everything ready to their hands, independent of any previous efforts on their part, just as we find the sun in the heavens. . . . And these spoiled masses are unintelligent enough to believe that the material and social organization, placed at their disposition like the air, is of the same origin, since apparently it never fails them, and is almost as perfect as the natural scheme of things. . . .
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> As they do not see, behind the benefits of civilization, marvels of invention and construction that can only be maintained by great effort and foresight, they imagine that their role is limited to demanding these benefits peremptorily, as if they were natural rights. In the disturbances caused by scarcity of food, the mob goes in search of bread, and the means it employs is generally to wreck the bakeries. This may serve as a symbol of the attitude adopted, on a greater and more complicated scale, by the masses of today towards the civilization by which they are supported.[5]

In an era when countless numbers of irresponsible intellectuals call for the destruction of technology and the return to a primitive

[5]José Ortega y Gasset, *The Revolt of the Masses* (New York: W.W. Norton, 1932), pp. 63–65.

"nature" that could only result in the death by starvation of the overwhelmingly greatest part of the world's population, it is instructive to recall Ortega's conclusion:

> Civilization is not "just there," it is not self-supporting. It is artificial and requires the artist or the artisan. If you want to make use of the advantages of civilization, but are not prepared to concern yourself with the upholding of civilization—you are done. In a trice you find yourself left without civilization. . . . The primitive forest appears in its native state, just as if curtains covering pure Nature had been drawn back.[6]

The steady decline in the underpinnings of our civilization began in the late nineteenth century, and accelerated during the World Wars I and II and the 1930s. The decline consisted of an accelerating retreat back from the Revolution, and of a shift back to the old order of mercantilism, statism, and international war. In England, the *laissez-faire* capitalism of Price and Priestly, of the Radicals and of Cobden and Bright and the Manchester school, was replaced by a Tory statism driving toward aggressive Empire and war against other imperial powers. In the United States the story was the same, as businessmen increasingly turned to the government to impose cartels, monopolies, subsidies, and special privileges. Here as in Western Europe, the advent of World War I was the great turning point—in aggravating the imposition of militarism and government—business economic planning at home, and imperial expansion and intervention overseas. The medieval guilds have been re-established in a new form—that of labor unions with their network of restrictions and their role as junior partners of government and industry in the new mercantilism. All the despotic trappings of the old order have returned in a new form. Instead of the absolute monarch, we have the President of the United States, wielding far more power than any monarch of the past. Instead of a constituted nobility, we have an Establishment of wealth and power that continues to rule us regardless of which political party is technically in power. The growth of a bipartisan civil service, of a bipartisan domestic and foreign policy, the advent of cool technicians of power who seem to sit in positions of command regardless of how we vote (the Achesons, the Bundys, the Baruchs, the McCloys, the J. Edgar Hoovers), all underscore our

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[6]Ibid., p. 97.

increasing domination by an elite that grows ever fatter and more privileged on the taxes that they are able to extract from the public hide.

The result of the aggravated network of mercantilist burdens and restrictions has been to place our economy under greater and greater strain. High taxes burden us all, and the military-industrial complex means an enormous diversion of resources, of capital, technology, and of scientists and engineers, from productive uses to the overkill waste of the military machine. Industry after industry has been regulated and cartelized into decline: the railroads, electric power, natural gas, and telephone industries being the most obvious examples. Housing and construction have been saddled with the blight of high property taxes, zoning restrictions, building codes, rent controls, and union featherbedding. As free-market capitalism has been replaced by state capitalism, more and more of our economy has begun to decay and our liberties to erode.

In fact, it is instructive to make a list of the universally acknowledged problem areas of our economy and our society, and we will find running through that list a common glaring leitmotif: government. In all the high problem areas, government operation or control has been especially conspicuous.

Let us consider:

Foreign policy and war: Exclusively governmental.

Conscription: Exclusively governmental.

Crime in the streets: The police and the judges are a monopoly of government, and so are the streets.

Welfare system: The problem is in government welfare; there is no special problem in the private welfare agencies.

Water pollution: Municipally owned garbage is dumped in government owned rivers and oceans.

Postal service: The failings are in the government owned Post Office, not, for example, among such highly successful private competitors as bus-delivered packages and the Independent Postal System of America, for third-class mail.

The military—industrial complex: Rests entirely on government contracts.

Railroads: Subsidized and regulated heavily by government for a century.

Telephone: A government-privileged monopoly.

Gas and electric: A government-privileged monopoly.

Housing: Bedeviled by rent controls, property taxes, zoning laws, and urban renewal programs (all government).

Excess highways: All built and owned by government.

Union restrictions and strikes: The result of government privilege, notably in the Wagner Act of 1935.

High taxation: Exclusively governmental.

The schools: Almost all governmental, or if not directly so, heavily government-subsidized and regulated.

Wiretapping and invasion of civil liberties: Almost all done by government.

Money and inflation: The money and banking system is totally under the control and manipulation of government.

Examine the problem areas, and everywhere, like a red thread, there lies the overweening stain of government. In contrast, consider the frisbee industry. Frisbees are produced, sold, and purchased without headaches, without upheavals, without mass breakdowns or protests. As a relatively free industry, the peaceful and productive frisbee business is a model of what the American economy once was and can be again—if it is freed of the repressive shackles of big government.

In *The Affluent Society*, written in the late 1950s, John Kenneth Galbraith pinpointed the fact that the governmental areas are our problem areas. But his explanation was that we have "starved" the public sector and that therefore we should be taxed more heavily in order to enlarge the public sector still further at the expense of the private. But Galbraith overlooked the glaring fact that the proportion of national income and resources devoted to government has been expanding enormously since the turn of the century. If the problems did not appear before, and have appeared increasingly in precisely the expanded governmental sector, the judicious might well conclude that perhaps the problem lies in the public sector itself. And that is precisely the contention of the free-market libertarian.

Problems and breakdowns are inherent in the operations of the public sector and of government generally. Deprived of a profit-and-loss test to gauge productivity and efficiency, the sphere of government shifts decision-making power from the hands of every individual and cooperating group, and places that power in the hands of an overall governmental machine. Not only is that machine coercive and inefficient; it is necessarily dictatorial because whichever decision it may make, there are always minorities or majorities whose desires and choices have been overridden. A public school must make one decision in each area: it must decide whether to be disciplined or progressive or some blend of the two; whether to be pro-capitalist or pro-socialist or neutral; whether to be integrated or segregated, elitist or egalitarian, and so on. Whatever it decides, there are citizens who are permanently deprived. But in the free market, parents are free to patronize whatever private or voluntary schools they wish, and different groups of parents will then be able to exercise their choice unhampered. The free market enables every individual and group to maximize its range of choice, to make its own decisions and choices and to put them into effect.

It is ironic that Professor Galbraith does not seem to be very happy about the public sector as it has lately been manifesting itself: in the military-industrial complex, in the war in Vietnam, in what Galbraith has himself properly derided as President Nixon's "Big Business Socialism." But if the glorious public sector, if expanded government, has brought us to this pretty pass, perhaps the answer is to roll government back, to return to the truly revolutionary path of dismantling the Big State.

Indeed, American liberals—who for decades have been the main heralds and apologists for big government and the welfare state—have increasingly become unhappy at the results of their own efforts. For just as in the days of oriental despotism, state rule cannot endure for long without a corps of intellectuals to spin the arguments and the rationale to gain the support and the sense of legitimacy among the public, and the liberals (the overwhelming majority of American intellectuals) have served since the New Deal as the celebrants of big government and the welfare state. But many liberals are coming to realize that they have been in power, have fashioned American society, for four decades now, and it is clear to them that something has gone radically wrong. After four decades of the welfare state at home and "collective security" abroad, the consequences of New Deal liberalism have clearly seen aggravated breakdowns and conflicts at home and perpetual war and intervention abroad. Lyndon Johnson, with whom liberals became extremely unhappy, correctly referred to Franklin Roosevelt as his "Big Daddy"—and the parentage on all foreign and domestic fronts was quite clear. Richard Nixon is scarcely distinguishable from his predecessor. If many liberals have become strangers and afraid in a world *they* have made, then perhaps the fault lies precisely in liberalism itself.

If, then, there is to be a rollback of statism, there will have to be another ideological revolution to match the rise of the classical radicals of the seventeenth and eighteenth centuries. Intellectuals will have to shift, in large part, back from their role as apologists for the State to resume their function as upholders of the standards of truth and reason as against the *status quo*. In the last several years, there have been signs of disenchantment by the intellectuals, but the shift has been largely a wrongheaded one. As a result, in the current split between liberals and radicals among the *intelligentsia*, *neither* side provides us with the requisites of civilization, with the requisites for maintaining a prosperous and free industrial order. The liberals have offered us the spurious rationality of technocratic service to the Leviathan State of fitting in as manipulated cogs in the bureaucratic government-industrial machinery. Liberalism's solution to every domestic problem is to tax and inflate more and to allocate more federal funds; its solution for foreign crises is to "send the Marines" (accompanied, of course, by politico-economic planners to alleviate the destruction that the Marines cause). Surely we cannot continue to accept the proffered solutions of a liberalism that has manifestly failed. But the tragedy is that the radicals have taken the liberals at their face value: identifying reason, technology, and industry with the current liberal-mercantilist order, the radicals, in order to reject the current system, have turned their backs on the former necessary virtues as well.

In short, the radicals, feeling themselves forced into a visceral rejection of the world of liberalism, of Vietnam and the public-school systems have adopted the liberals' own identification of their own system with reason, industry, and technology. Hence the radicals raise the cry for the rejection of reason on behalf of emotions and vague mysticism, of rationality for inchoate and capricious spontaneity, of work and foresight for hedonism and dropping out, of technology and industry for the return to "nature" and the primitive tribe. In doing so, in adopting this pervasive nihilism, the radicals are offering us even less of a viable solution than their liberal enemies. For the murder of millions in Vietnam they would, in effect, substitute the death by starvation of the vast bulk of the world's population. The radicals' vision cannot be accepted by sane peoples and the bulk of Americans, their ignorance or errors otherwise, are astute enough to recognize this fact and to make loud, clear, and sometimes brutal their rejection of the radicals and their alternative ethic, society, and life-style.

The point of this essay is that the public need not be forced to choose between the alternative of repressive and stifling welfare-warfare state monopoly liberalism on the one hand, or the irrational and nihilistic return to tribal primitivism on the other. The radical alternative is evidently not compatible with a prosperous life and industrial civilization; this much is crystal clear. But less clear is the fact that corporate state liberalism is in the long run also not compatible with an industrial civilization. The one route offers our society a quick suicide; the other a slow and lingering murder.

There is, then, a third alternative—one that has still gone unheeded amid the great debate between liberals and radicals. That alternative is to return to the ideals and to the structure that generated our industrial order and that is needed for that order's long-run survival—to return to the system that will bring us industry, technology, and rapidly advancing prosperity *without* war, militarism, or stifling governmental bureaucracy. That system is *laissez-faire* capitalism, what Adam Smith called "the natural system of liberty," a system that rests on an ethic that encourages individual reason, purpose, and achievement. The nineteenth-century libertarian theorists—men like the Frenchmen of the Restoration era, Charles Comte and Charles Dunoyer, and the Englishman Herbert Spencer—saw clearly that militarism and statism are relics and throwbacks of the past, that they are incompatible with the functioning of an industrial civilization. That is why Spencer and the others contrasted the "military" with the "industrial" principle, and judged that one or the other would have to prevail.

What I am suggesting, in short, in the oversimplified categories made popular by Charles Reich, is a return to "Consciousness I"—a

Consciousness that is brusquely dismissed by Reich and his readers as they proceed to take sides in the great debate between Consciousness II and III. To Reich, Consciousness I was made obsolete by the growth of modern technology and mass production, which made the turn to the corporate state inevitable. But here Reich is not being radical *enough*; he is simply adopting the conventional liberal historiography that big government was made necessary by the growth of large-scale industry. If he were familiar with economics, Reich would realize that it is precisely advanced industrial economies that require a free market to survive and flourish; on the contrary, an agricultural society can plod along indefinitely under despotism provided that the peasants are left enough of their produce to survive. The Communist countries of Eastern Europe have discovered this fact in recent years; hence, the more they industrialize, the greater and more inexorable their movement away from socialism and central planning and toward a free-market economy. The rapid shift of the East European countries toward the free market is one of the most heartening and dramatic developments in the last two decades; yet the trend has gone almost unnoticed, for the left finds the shift away from statism and egalitarianism in Yugoslavia and the other East European countries extremely embarrassing, while the conservatives are reluctant to concede that there may be *anything* hopeful about the Communist nations.

Furthermore, Reich is clearly unaware of the finds of Gabriel Kolko and other recent historians that completely revise our picture of the origins of the current welfare-warfare state. Far from large-scale industry forcing the knowledge that regulation and big government were inevitable, it was precisely the *effectiveness* of free-market competition that led big businessmen seeking monopoly to turn to the government to provide such privileges. There was nothing in the economy that objectively required a shift from Consciousness I to Consciousness II: only the age-old desire of men for subsidy and special privilege created the "counter revolution" of statism. In fact, as we have seen, this development only cripples and hampers the workings of modern industry; objective reality would require a return to Consciousness I. In this world of remarkably swift changes in values and ideologies, such a change in consciousness cannot be ruled out as impossible; far stranger things have been happening.

In one sense, the adoption of libertarian values and institutions would be a return; in another, it would be a profound and radical advance. For while the older libertarians were essentially revolutionary, they allowed partial successes to turn themselves strategically and tactically into seeming defenders of the *status quo*, mere resisters of change. In taking this stance, the earlier libertarians lost their radical perspective; for libertarianism has never come fully that into being. What they must do is become "radicals" once again, as Jefferson and Price and Cobden and Thoreau were before them. To do this they must hold aloft the banner of their ultimate goal, the ultimate triumph of the age-old logic of the concepts of free market, liberty, and private property rights. That ultimate goal is the dissolution of the State into the social organism, the privatizing of the public sector. In contrast to the dysfunctional vision of the New Left, this is a goal wholly compatible with the functioning of an industrial society—and with peace and freedom as well. All too many of the older libertarians lacked the intellectual courage to press on—to call for total victory rather than settle for partial triumph—to apply their principles to the fields of money, police, the courts, the State itself. They failed to heed the injunction of William Lloyd Garrison that "gradualism in theory is perpetuity in practice." For if the pure theory is never held aloft, how can it ever be achieved?

36

A Future of Peace and Capitalism

In order to discuss the "future of capitalism," we must first decide what the meaning of the term "capitalism" really is. Unfortunately, the term "capitalism" was coined by its greatest and most famous enemy, Karl Marx. We really can't rely upon him for correct and subtle usage. And, in fact, what Marx and later writers have done is to lump together two extremely different and even contradictory concepts and actions under the same portmanteau term. These two contradictory concepts are what I would call "free-market capitalism" on the one hand, and "state capitalism" on the other.

The difference between free-market capitalism and state capitalism is precisely the difference between, on the one hand, peaceful, voluntary exchange, and on the other, violent expropriation. An example of a free-market exchange is my purchase of a newspaper on the corner for a dime; here is a peaceful, voluntary exchange beneficial to both parties. I buy the newspaper because I value the newspaper more highly than the dime that I give up in exchange; and the newsdealer sells me the paper because, he, in turn, values the dime more highly than the newspaper. Both parties to the exchange benefit. And what we are both doing in the exchange is the swapping of titles of ownership: I relinquish the ownership of my dime in exchange for the paper, and the newsdealer performs the exact opposite change of title. This simple exchange of a dime for a newspaper is an example of a unit free-market act; it is the market at work.

This essay appeared in James H. Weaver, ed., *Modern Political Economy* (Boston: Allyn and Bacon, 1973), pp. 419–30, as chapter 28; it followed an essay by Professor Robert T. Averitt, to which Rothbard refers once or twice in his piece. One footnote supplied by the original editor has been removed. This essay has been published under the title "The Future of Capitalism."

In contrast to this peaceful act, there is the method of violent expropriation. Violent expropriation occurs when I go to the newsdealer and seize his newspapers or his money at the point of a gun. In this case, of course, there is no mutual benefit; I gain at the expense of the victimized newsdealer. Yet the difference between these two transactions—between voluntary mutual exchange, and the holdup at gunpoint—is precisely the difference between free market capitalism and state capitalism. In both cases we obtain something—whether it be money or newspapers—but we obtain them in completely different ways, ways with completely different moral attributes and social consequences.

Here I can't resist the temptation of pointing out that I have an entirely different interpretation of Jefferson and Hamilton from that of Professor Averitt. I don't regard Jefferson as some sort of early Franz Boas type, an early Left-Wing anthropologist. He wasn't. My reading of Jefferson is completely different; on my reading, Jefferson was very precisely in favor of *laissez-faire,* or free-market, capitalism. And that was the real argument between them. It wasn't really that Jefferson was against factories or industries *per se*; what he was against was coerced development, that is, taxing the farmers through tariffs and subsidies to build up industry artificially, which was essentially the Hamilton program.

Jefferson, incidentally, along with other statesmen of his time, was a very learned person. He read Adam Smith, he read Ricardo, he was very familiar with *laissez-faire* classical economics. And so his economic programs far from being the expression of bucolic agrarian nostalgia, was a very sophisticated application of classical economics to the American scene. We must not forget that *laissez-faire* classicists were also against tariffs, subsidies, and coerced economic development.

Furthermore, the term "equality," as used by Jefferson and Jeffersonians, was employed in the same sense as Jefferson's friend and colleague George Mason used when he framed the Virginia Declaration of Rights shortly before Jefferson wrote the Declaration of Independence: "that all men are by nature equally free and independent." In other words, "equality" did not then mean what we often mean by equality now: equality of condition or uniformity. "Equality" meant that each person has the right to be equally free and independent, to enjoy the right to "equal liberty," as Herbert Spencer would phrase it a century later. In other words, again what I am saying is that the Jeffersonian wing of the Founding Fathers was essentially free-market, *laissez-faire* capitalists.

To return to the market: the free market is really a vast network, a latticework, of these little, unit exchanges which I mentioned before: such as exchanging a dime for a newspaper. At each step of the way, there are two people, or two groups of people, and these two people or groups exchange two commodities, usually money and another commodity; at each step, each benefits by the exchange, otherwise they wouldn't be making it in the first place. If it turns out that they were mistaken in thinking that the exchange would benefit them then they quickly stop, and they don't make the exchange again.

Another common example of a free market is the universal practice of children swapping baseball cards—the sort of thing where you swap "two Hank Aaron[s]" for "one Willie Mays." The "prices" of the various cards, and the exchanges that took place, were based on the relative importance that the kids attached to each baseball player. As one way of annoying liberals we might put the case this way: liberals are supposed to be in favor of any voluntary actions performed, as the famous cliché goes, by "two consenting adults." Yet it is peculiar that while liberals are in favor of any sexual activity engaged in by two consenting adults, when these consenting adults engage in trade or exchange, the liberals step in to harass, cripple, restrict, or prohibit that trade. And yet both the consenting sexual activity and the trade are similar expressions of liberty in action. Both should be favored by any consistent libertarian. But the government, especially a liberal government, habitually steps in to regulate and restrict such trade.

It is very much as though I were about to exchange two Hank Aarons for one Willie Mays, and the government, or some other third party, should step in and say: "No, you can't do that; that's evil; it's against the common good. We hereby outlaw this proposed exchange; any exchange of such baseball cards must be one for one, or three for two"—or whatever other terms the government, in its wisdom and greatness, arbitrarily wishes to impose. By what right do they do this? The libertarian claims, by no right whatsoever.

In general, government intervention can be classified in two ways: either as prohibiting or partially prohibiting an exchange between two people—between two consenting adults, an exchange beneficial to both parties; or forcing someone to make an "exchange" with the government unilaterally, in which the person yields something up to the government under the threat of coercion. The first may include outright prohibition of an exchange, regulating the terms—the price—of the exchange, or preventing certain people from making the exchange. As an example of the last intervention, in order to be a photographer in most states, one must be a duly licensed photographer—proving that one is of "good moral character" and paying a certain amount of moolah to the state apparatus. This in order to have the right to take somebody's picture! The second kind of intervention is a forced "exchange" between us and the government, an "exchange" that benefits only the government and not ourselves. Of course, taxation is the obvious and evident example of that. In contrast to voluntary exchange, taxation is a matter of leaping in and coercively seizing people's property without their consent.

It is true that many people seem to believe that taxation is not imposed without our consent. They believe, as the great economist Joseph Schumpeter once said, that taxes are something like club dues, where each person voluntarily pays his share of the expenses of the club. But if you really think that, try not paying your taxes sometime and see what happens. No "club" that I know of has the power to come and seize your assets or jail you if you don't pay its dues. In my view, then, taxes are exploitation—taxes are a "zero-sum" game. If there's anything in the world that's a zero-sum game, it's taxation. The government seizes money from one set of people, gives it to another set of people, and in the meanwhile of course lops off a large chunk for its own "handling expenses." Taxation, then, is purely and pristinely robbery. Period.

As a matter of fact, I challenge any of you to sit down and work out a definition of taxation that would not also be applicable to robbery. As the great libertarian writer H.L. Mencken once pointed out, among the public, even if they are not dedicated libertarians, robbing the government is never considered on the same moral plane as robbing another person. Robbing another person is generally deplored; but if the government is robbed all that happens, as Mencken put it, "is that certain rogues and loafers have less money to play with than they had before."

The great German sociologist Franz Oppenheimer, who wrote a magnificent little book called *The State*, put the case brilliantly. In essence, he said, there are only two ways for men to acquire wealth. The first method is by producing a good or a service and voluntarily exchanging that good for the product of somebody else. This is the method of exchange, the method of the free market; it's creative and expands production; it is not a zero-sum game because production expands and both parties to the exchange benefit. Oppenheimer called this method the "economic means" for the acquisition of wealth. The second method is seizing another person's property without his consent, i.e., by robbery, exploitation, looting. When you seize someone's property without his consent, then you are benefiting at his expense, at the expense of the producer; here is truly a zero-sum "game"—not much of a "game," by the way, from the point of view of the victim. Instead of expanding production, this method of robbery clearly hobbles and restricts production. So in addition to being immoral while peaceful exchange is moral, the method of robbery hobbles production because it is parasitic upon the effort of the producers. With brilliant astuteness, Oppenheimer called this method of obtaining wealth "the political means." And then he went on to define the state, or government, as "the organization of the political means," i.e., the regularization, legitimation, and permanent establishment of the political means for the acquisition of wealth.

In other words, the state is organized theft, organized robbery, organized exploitation. And this essential nature of the state is highlighted by the fact that the state ever rests upon the crucial instrument of taxation.

I must here again comment on Professor Averitt's statement about "greed." It's true: greed has had a very bad press. I frankly don't see anything wrong with greed. I think that the people who are always attacking greed would be more consistent with their position if they refused their next salary increase. I don't see even the most Left-Wing scholar in this country scornfully burning his salary check. In other words, "greed" simply means that you are trying to relieve the nature-given scarcity that man was born with. Greed will continue until the Garden of Eden arrives, when everything is superabundant, and we don't have to worry about economics at all. We haven't of course reached that point yet; we haven't reached the point where everybody is burning his salary increases, or salary checks in general. So the question then becomes: what kind of greed are we going to have, "productive greed," where people produce and voluntarily exchange their products with others? Or exploitative greed, organized robbery and predation, where you achieve your wealth at the expense of others? These are the two real alternatives.

Returning to the state and taxation, I would point out incidentally that Saint Augustine, who is not famous for being a libertarian, did however set forth an excellent libertarian parable. He wrote that Alexander the Great had seized some pirate, and asked the pirate what he meant by seizing possession of the sea. And the pirate boldly replied: "What you mean by seizing the whole earth; but because I do it with a little ship, I am called a robber, while you, because you do it with a great fleet are called an emperor." Here Augustine highlights the fact that the state is simply robbery writ large, on an enormous scale, but robbery legitimated by intellectual opinion.

Take, for another example, the Mafia, which also suffers from a bad press. What the Mafia does on a local scale, the state does on an enormous scale, but the state of course has a much better press.

In contrast to the age-old institution of statism, of the political means, free-market capitalism arrived as a great revolutionary movement in the history of man. For it came into a world previously marked by despotism, by tyranny, by totalitarian control. Emerging first in the Italian city states, free market capitalism arrived full scale with the Industrial Revolution in Western Europe, a revolution that brought about a remarkable release of creative energy and productive ability, an enormous increase of production. You can call that "greed" if you wish; you can attack as "greed" the desire of someone on a poverty level who wishes to better his lot.

This reminds me of an interesting point on "greed" that cuts across the usual "Left-Right" continuum. I remember when Russell Kirk first launched the contemporary conservative movement in this country, in the mid-1950s. One of the leading young conservatives of that era addressed a rally, and opined that the whole trouble with the world, and the reason for the growth of the Left, is that everyone is "greedy," the masses of Asia are "greedy," and so on. Here was a person who owned half of Montana, attacking the mass of the world population, who were trying to rise above the subsistence level, to better their lot a bit. And yet they were "greedy."

At any rate, free-market capitalism, the Industrial Revolution, saw an enormous outpouring of productive energies, an outpouring that constituted a revolution against the mercantilist system of the seventeenth and eighteenth centuries In fact the mercantilist system is essentially what we've got right now. There is very little difference between state monopoly capitalism, or corporate state capitalism, whatever you want to call it, in the United States and Western Europe today, and the mercantilist system of the pre-Industrial Revolution era. There are only two differences; one is that their major activity was commerce and ours is industry. But the essential *modus operandi* of the two systems is exactly the same: monopoly privilege, a complete meshing in what is now called the "partnership of government and industry," a pervasive system of militarism and war contracts, a drive toward war and imperialism; the whole shebang characterized the seventeenth and eighteenth centuries. The really key difference is that they didn't have a gigantic P.R. apparatus; they did not have a fleet of intellectuals trumpeting to all and sundry the wonders of the system: how it promotes the common good and the general welfare, how this is Liberalism In Action. They said, "We're out to shaft the public and we're doing it!" They were very honest in those days. It's really refreshing, by the way, to go back and read the material before 1914 and bask in the honesty of the period.

One of the concepts important in this connection is that of Albert Jay Nock, a great libertarian thinker and follower of Franz Oppenheimer. Nock coined two concepts: what he called "social power" on the one hand, and "state power" on the other. Social power is essentially what I have been talking about: the productive energies released by the free market, by voluntary exchanges, people interacting voluntarily and peacefully. "State power" is parasitism, exploitation, and the state apparatus in general—organized taxes, regulation, etc. And Nock saw history as essentially a race between social power and state power. In the Industrial Revolution period, for example, from various circumstances state power was minimal, and this allowed social power to take a tremendous burst upward. And what has happened in the twentieth century is essentially that state power has caught up; they've moved in on society and started crippling it once again.

What, then, is my view of the "future of capitalism"—our topic for today? My view of the future is highly optimistic. I really think that free-market capitalism, even though it is supposed to be a reactionary, Neanderthal institution, is the wave of the future. For one thing, it was the wave of the future a hundred and two hundred years ago, and what we have now is only a reactionary reversion to the previous system.

The present system is not really "progressive" at all. Second, it was discovered by Ludwig von Mises back in 1920 that socialism—the other polar alternative to our present neo-mercantilism—cannot run an industrial system.

An agricultural system can be run indefinitely by almost anyone, as long as you leave the peasants alive. You can have almost any kind of tyrannical system over the peasants. But in an industrial system you need much more than that: you need a market, you need profit-and-loss tests, you can't run the system haphazardly. And Mises proved that a socialist system cannot calculate economically, because it doesn't have a price system for capital goods, and therefore socialism will not be able to run an industrial system.

All the textbooks say that Mises was quickly refuted by Oskar Lange and others, but he really wasn't refuted. I haven't got time to go into the theoretical argument. But in practice what has happened is that, in response to industrialization, there has been a tremendous shift in the last fifteen years in the socialist countries of Eastern Europe away from socialism and toward a free market. For a believer in freedom and the free market, this shift is one of the most exciting developments of the past two decades. Now there are only two interpretations of this development: either you have to say, as the Chinese do, that the Yugoslavs, the Poles, the Czechs, the Slovaks, the Hungarians have all sold out to capitalism—they've gone in secret to the American Embassy and received their pay. Or you have to say that something deeper is happening, that what is essentially happening is that they tried socialism and it didn't work, especially as the economies began to industrialize. They found in practice, pragmatically, without reading Mises (though there's evidence that they've read Mises by this time) and Hayek and others, that socialism can't calculate, they came to that conclusion themselves. Lenin, indeed, came to that conclusion very early, when "War Communism" was scrapped in 1921.

"War Communism" was an attempt, shortly after the Bolshevik Revolution, to leap into full communism, into an economy without money and without prices, in which everyone was supposed to—and in practice was forced to—present his goods to the common heap, and withdraw from that heap to satisfy his needs.

The system of War Communism proved to be a total disaster—not because of the Civil War (that rationalization only came much later), but because of the communist system itself.[1] Lenin soon realized what was happening, and quickly instituted the New Economic Policy, which was essentially a return to a quasi-free market system.

Now the Eastern European countries, especially Yugoslavia, have been moving very rapidly since the 1950s away from socialism and central planning and toward a free-market system. In Yugoslavia, for example, agriculture, still the main industry, is almost completely private; a flourishing private sector exists in trade and small manufacturing; and the "public sector" has been turned over in fact as well as in law by the state to the ownership of the workers in the various plants—essentially functioning as producers' cooperatives. Furthermore, there is substantially a free market between these producers' co-ops, with a flourishing price system, stern profit and loss tests (when a firm loses enough money, it goes bankrupt). Moreover, the most recent Yugoslav economic reform which began in 1967 and is still underway, saw a tremendous drop in the rate of taxation of their co-ops—a drop from the previous approximately 70 per cent income tax rate to about 20 per cent. This means that, the central Yugoslav government no longer exercises complete control over investment: investment, too, has been decentralized and destatized. As a matter of fact, if one reads the Communist economists in Yugoslavia—especially in the relatively industrialized areas of Croatia and Slovenia—they sound very much like Barry Goldwater or Ronald Reagan. "Why should we productive Croats or Slovenes," they ask, "be taxed in order to subsidize those lazy slobs down in Montenegro?" And: "why should we build uneconomic ("political") factories? Everyone should stand on their own feet," etc. The next step in Yugoslavia is that the banks—which, incidentally, are largely competitive private co-ops owned by their business clients—are agitating for a stock market in

[1]On War Communism, see the important article by Paul Craig Roberts, "War Communism: A Re-examination," *Slavic Review* (June 1970): 237–61.

a Communist country, which would have been considered incredible ten or twenty years ago. And what they are proposing to call this system—literally—is "socialist people's capitalism."

On this point, a few years ago I was teaching a course in Comparative Economic Systems. Naturally, I spent the term praising the free market, and attacking socialism and central planning. Finally, I invited an exchange professor from Hungary—an eminent Communist economist—to give a guest lecture, and the kids felt: "Ah, at least we're going to get the other side of the picture." And what did the Hungarian economist do? He spent the entire lecture praising the free market and attacking central planning. He said almost exactly what I had been saying up till then.

In Eastern Europe, then, I think that the prospects for the free market are excellent—I think we're getting free-market capitalism and that its triumph there is almost inevitable. In the United States, the prospects are a little more cloudy, but here too we see the "New Left" picking up a lot of the positions that we "extreme Right-Wingers" used to have. Much of the position that used to be called "extreme Right-Wing" twenty years ago is now considered quite leftish. As a result, I, with the same position I had then, have been shifted bodily from extreme right to left without any effort on my part at all. Decentralization; community control; attack on Leviathan government, on bureaucracy, on government interference with each person's life; attack on the state-ridden educational system; criticism of unionism, which is tied up with the state; opposition to militarism, war, imperialism, and conscription; all these things that the Left is now beginning to see, is precisely what we "extreme Right-Wingers" have been saying all along. And, as far as "decentralization" goes, there is nothing that is so decentralized as the free market, and perhaps this too will come to the attention of the public.

And so, I'm very optimistic about the future of free-market capitalism. I'm not optimistic about the future of state capitalism—or rather, I am optimistic, because I think it will eventually come to an end. State capitalism inevitably creates all sorts of problems which become insoluble; as Mises again has pointed out, one intervention into the system to try to solve problems only creates other problems, which then demand further interventions, etc., and so the whole process keeps snowballing until you have a completely collectivist, totalitarian system. It's very much like the escalation in Vietnam, by the way; the principle, as we all know by this time, is that government intervention in Vietnam creates problems which demand further escalation, etc. The same thing happens in domestic intervention, the farm program being a splendid example of this process. Both in Vietnam and in domestic government intervention, each escalating step only creates more problems which confront the public with the choice: either press on further with more interventions, or repeal them—in Vietnam, withdraw from the country. Now in Yugoslavia and the rest of Eastern Europe, they have taken the opposite path: of progressive de-escalation, of continuing repeal of one intervention after another, and on toward the free market. In the United States we have so far taken the path of accelerating interventions, of ever greater hobbling of tile free market. But it is beginning to become evident that the mixed system is breaking down, that it doesn't work. It's beginning to be seen, for example, that the Welfare State does not tax the rich and give to the poor; it taxes the poorer to give to the richer, and the poor in essence pay for the Welfare State. It is beginning to be seen that foreign intervention is essentially a method of subsidizing favored American corporations instead of helping out the poor in the undeveloped countries. And it is now becoming evident that the Keynesian policies only succeeded in bringing us to the present impasse of inflation-cum-recession, and that our Olympian economists have no way of getting out of the present mess at all, except to cross their fingers and their econometric models and pray. And, of course, we can look forward to another balance-of-payments crisis in a couple of years, another episode of inflationary crisis in a couple of years, another episode of gold-outflow hysteria.

Thus, we have a lot of crises looming in America, some on their way, others imminent or already here. All of these crises are the products of intervention, and none of them can really be solved by more intervention. Again, I believe that we will eventually reverse our present course—perhaps taking Yugoslavia as our paradigm. Incidentally, Professor Averitt mentioned the Great Depression. The Great Depression has always been considered as the product of free-market capitalism of the 1920s. It was the result of very heavy government intervention in the 1920s, an intervention, by the way, that is very similar to the current intervention. In the 1920s, we had the newly imposed Federal Reserve System, which all the Establishment economists of the day assured us would eliminate all future depressions; the

Federal Reserve System would henceforth manipulate prices and the money supply and iron out business cycles forever. Nineteen twenty-nine and the Great Depression were the results of that manipulation guided by the wise hands of Establishment economics—they were not the results of anything like free-market capitalism.

In short, the advent of industrialism and the Industrial Revolution has irreversibly changed the prognosis for freedom and statism. In the pre-industrial era, statism and despotism could peg along indefinitely, content to keep the peasantry at subsistence levels and to live off their surplus. But industrialism has broken the old tables; for it has become evident that socialism cannot run an industrial system, and it is gradually becoming evident that neomercantilism, interventionism, in the long run cannot run an industrial system either. Free-market capitalism, the victory of social power and the economic means, is not only the only moral and by far the most productive system; it has become the only viable system for mankind in the industrial era. Its eventual triumph is therefore virtually inevitable.

Section Six

Money, Banking, and Calculation

37
The Austrian Theory of Money

The Austrian theory of money virtually begins and ends with Ludwig von Mises's monumental *Theory of Money and Credit*, published in 1912.[1] Mises's fundamental accomplishment was to take the theory of marginal utility, built up by Austrian economists and other marginalists as the explanation for consumer demand and market price, and apply it to the demand for and the value, or the price, of money. No longer did the theory of money need to be separated from the general economic theory of individual action and utility, of supply, demand, and price; no longer did monetary theory have to suffer isolation in a context of "velocities of circulation," "price levels," and "equations of exchange."

In applying the analysis of supply and demand to money, Mises used the Wicksteedian concept: supply is the total stock of a commodity at any given time; and demand is the total market demand to gain and hold cash balances, built up out of the marginal-utility rankings of units of money on the value scales of individuals on the market. The Wicksteedian concept is particularly appropriate to money for several reasons: first, because the supply of money is either extremely durable in relation to current production, as under the gold standard, or is determined exogenously to the market by government authority; and, second and most important, because money, uniquely among commodities desired and demanded on the market,

Originally appeared as a chapter in *The Foundations of Modern Austrian Economics*, Edwin Dolan, ed. (Kansas City: Sheed Andrews and McMeel, 1976), pp. 160–84.

[1]Ludwig von Mises, *Theorie des Geldes und der Umlaufsmittel* (1912); see the third English edition, *The Theory of Money and Credit* (New Haven, Conn.: Yale University Press, 1953).

is acquired not to be consumed, but to be held for later exchange. Demand-to-hold thereby becomes the appropriate concept for analyzing the uniquely broad monetary function of being held as stock for later sale. Mises was also able to explain the demand for cash balances as the resultant of marginal utilities on value scales that are strictly ordinal for each individual. In the course of his analysis Mises built on the insight of his fellow Austrian Franz Cuhel to develop a marginal utility that was strictly ordinal, lexicographic, and purged of all traces of the error of assuming the measurability of utilities.

The relative utilities of money units as against other goods determine each person's demand for cash balances, that is, how much of his income or wealth he will keep in cash balances as against how much he will spend. Applying the law of diminishing (ordinal) marginal utility of money and bearing in mind that money's "use" is to be held for future exchange, Mises arrived implicitly at a falling demand curve for money in relation to the purchasing power of the currency unit. The purchasing power of the money unit, which Mises also termed the "objective exchange-value" of money, was then determined, as in the usual supply-and-demand analysis, by the intersection of the money stock and the demand for cash balance schedule. We can see this visually by putting the purchasing power of the money unit on the y-axis and the quantity of money on the x-axis of the conventional two-dimensional diagram corresponding to the price of any good and its quantity. Mises wrapped up the analysis by pointing out that the total supply of money at any given time is no more or less than the sum of the individual cash balances at that time. No money in a society remains unowned by someone and is therefore outside some individual's cash balances.

While, for purposes of convenience, Mises's analysis may be expressed in the usual supply-and-demand diagram with the purchasing power of the money unit serving as the price of money, relying solely on such a simplified diagram falsifies the theory. For, as Mises pointed out in a brilliant analysis whose lessons have still not been absorbed in the mainstream of economic theory, the purchasing power of the money unit is not simply the inverse of the so-called price level of goods and services. In describing the advantages of money as a general medium of exchange and how such a general medium arose on the market, Mises pointed out that the currency unit serves as unit of account and as a common denominator of all other prices, but that the money commodity itself is still in a state of barter with all other goods and services. Thus, in the pre-money state of barter, there is no unitary "price of eggs"; a unit of eggs (say, one dozen) will have many different "prices": the "butter" price in terms of pounds of butter, the "hat" price in terms of hats, the "horse" price in terms of horses, and so on. Every good and service will have an almost infinite array of prices in terms of every other good and service. After one commodity, say gold, is chosen to be the medium for all exchanges, every other good except gold will enjoy a unitary price, so that we know that the price of eggs is one dollar a dozen; the price of a hat is ten dollars, and so on. But while every good and service except gold now has a single price in terms of money, money itself has a virtually infinite array of individual prices in terms of every other good and service. To put it another way, the price of any good is the same thing as its purchasing power in terms of other goods and services. Under barter, if the price of a dozen eggs is two pounds of butter, the purchasing power of a dozen eggs is, *inter alia*, two pounds of butter. The purchasing power of a dozen eggs will also be one-tenth of a hat, and so on. Conversely, the purchasing power of butter is its price in terms of eggs; in this case the purchasing power of a pound of butter is a half-dozen eggs. After the arrival of money, the purchasing power of a dozen eggs is the same as its money price, in our example, one dollar. The purchasing power of a pound of butter will be fifty cents, of a hat ten dollars, and so forth.

What, then, is the purchasing power, or the price, of a dollar? It will be a vast array of all the goods and services that can be purchased for a dollar, that is, of all the goods and services in the economy. In our example, we would say that the purchasing power of a dollar equals one dozen eggs, or two pounds of butter, or one-tenth of a hat, and so on, for the entire economy. In short, the price, or purchasing power, of the money unit will be an array of the quantities of alternative goods and services that can be purchased for a dollar. Since the array is heterogeneous and specific, it cannot be summed up in some unitary price-level figure.

The fallacy of the price-level concept is further shown by Mises's analysis of precisely how prices rise (that is, the purchasing power of money falls) in response to an increase in the quantity of money (assuming, of course, that the individual demand schedules for cash balances or, more generally, individual value scales remain constant).

In contrast to the hermetic neoclassical separation of money and price levels from the relative prices of individual goods and services, Mises showed that an increased supply of money impinges differently upon different spheres of the market and thereby ineluctably changes relative prices.

Suppose, for example, that the supply of money increases by 20 percent. The result will not be, as neoclassical economics assumes, simply an across-the-board increase of 20 percent in all prices. Let us assume the most favorable case—what we might call the Angel Gabriel model—that the Angel Gabriel descends and overnight increases everyone's cash balance by precisely 20 percent. Now all prices will not simply rise by 20 percent; for each individual has a different value scale, a different ordinal ranking of utilities, including the relative marginal utilities of dollars and of all the other goods on his value scale. As each person's stock of dollars increases, his purchases of goods and services will change in accordance with their new position on his value scale in relation to dollars. The structure of demand will therefore change, as will relative prices and relative incomes in production. The composition of the array constituting the purchasing power of the dollar will change.

If relative demands and prices change in the Angel Gabriel model, they will change much more in the course of real-world increases in the supply of money. For, as Mises showed, in the real world an inflation of money is alluring to the inflators precisely because the injection of new money does not follow the Angel Gabriel model. Instead, the government or the banks create new money to be spent on specific goods and services. The demand for these goods thereby rises, raising these specific prices. Gradually, the new money ripples through the economy, raising demand and prices as it goes. Income and wealth are redistributed to those who receive the new money early in the process, at the expense of those who receive the new money late in the day and of those on fixed incomes who receive no new money at all. Two types of shifts in relative prices occur as the result of this increase in money: (1) the redistribution from late receivers to early receivers that occurs during the inflation process and; (2) the permanent shifts in wealth and income that continue even after the effects of the increase in the money supply have worked themselves out. For the new equilibrium will reflect a changed pattern of wealth, income, and demand resulting from the changes during the intervening inflationary process. For example, the fixed income groups permanently lose in relative wealth and income.[2]

If the concept of a unitary price level is a fallacious one, still more fallacious is any attempt to measure changes in that level. To use our previous example, suppose that at one point in time the dollar can buy one dozen eggs, or one-tenth of a hat, or two pounds of butter. If, for the sake of simplicity, we restrict the available goods and services to just these three, we are describing the purchasing power of the dollar at that time. But suppose that at the next point in time, perhaps because of an increase in the supply of dollars, prices rise, so that butter costs one dollar a pound, a hat twelve dollars, and eggs three dollars a dozen. Prices rise but not uniformly, and all that we can now say quantitatively about the purchasing power of the dollar is that it is four eggs, or one-twelfth of a hat, or one pound of butter. It is impermissible to try to group the changes in the purchasing power of the dollar into a single average index number. Any such index conjures up some sort of totality of goods whose relative prices remain unchanged, so that a general averaging can arrive at a measure of changes in the purchasing power of money itself. But we have seen that relative prices cannot remain unchanged, much less the valuations that individuals place upon these goods and services.[3]

Just as the price of any good tends to be uniform, so the price, or purchasing power of money, as Mises demonstrated, will tend to be uniform throughout its trading area. The purchasing power of the dollar will tend to be uniform throughout the United States. Similarly, in the era of the gold standard, the purchasing power of a unit of gold tended to be uniform throughout those areas where gold was

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[2]On the changes in relative prices attendant on an increase in the money supply, see Mises, *Theory of Money and Credit*, pp. 139–45.

[3]For more on the fallacies of measurement and index numbers, see Mises, *Theory of Money and Credit*, pp. 187–94; idem, *Human Action: A Treatise on Economics* (New Haven, Conn.: Yale University Press, 1949), pp. 221–24; Murray N. Rothbard, *Man, Economy, and State* (Princeton, N.J.: D. Van Nostrand, 1962), vol. 2, pp. 737–40; Bassett Jones, *Horses and Apples: A Study of Index Numbers* (New York: John Day, 1934); and Oskar Morgenstern, *On the Accuracy of Economic Observations*, 2nd rev. ed. (Princeton, N.J.: Princeton University Press, 1963).

in use. Critics who point to persistent tendencies for differences in the price of money between one location and another fail to understand the Austrian concept of what a good or a service actually is. A good is not defined by its technological properties but by its homogeneity in relation to the demands and wishes of the consumers. It is easy to explain, for example, why the price of wheat in Kansas will not be the same as the price of wheat in New York. From the point of view of the consumer in New York, the wheat, while technologically identical in the two places, is in reality two different commodities: one being "wheat in Kansas" and the other "wheat in New York." Wheat in New York, being closer to his use, is a more valuable commodity than wheat in Kansas and will have a higher price on the market. Similarly, the fact that a technologically similar apartment will not have the same rental price in New York City as in rural Ohio does not mean that the price of the same apartment commodity differs persistently; for the apartment in New York enjoys a more valuable and more desirable location and hence will be more highly priced on the market. The "apartment in New York" is a different and more valuable good than the "apartment in rural Ohio," since the respective locations are part and parcel of the good itself. At all times, a homogeneous good must be defined in terms of its usefulness to the consumer rather than by its technological properties.

To extend the analysis, the fact that the cost of living may be persistently higher in New York than in rural Ohio does not negate the tendency for a uniform purchasing power of the dollar throughout the country. For the two locations constitute a different set of goods and services, New York providing a vastly wider range of goods and services to the consumer. The higher costs of living in New York are the reflection of the greater locational advantages, of the more abundant range of goods and services available.[4]

In his valuable history of the theory of international prices, C.Y. Wu emphasized the Mises contribution and pointed out that Mises's explanation was in the tradition of Ricardo and Nassau Senior, who

> was the first economist to give a clear explanation of the meaning of the classical doctrine that the value of money was everywhere

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[4]See Mises, *Theory of Money and Credit*, pp. 170–78.

> the same and to demonstrate that differences in the prices of goods of similar composition in different places were perfectly reconcilable with the assumption of an equality of the value of money.[5]

Pointing out that Mises arrived at this concept independently of Senior, Wu then developed Mises's application to the alleged locational differences in the cost of living. As Wu stated,

> To him [Mises] those who believe in national differences in the value of money have left out of account the positional factor in the nature of economic goods; otherwise they should have understood that the alleged differences are explicable by differences in the quality of the commodities offered and demanded.

Wu concluded with a quote from Mises's *Theory of Money and Credit*:

> The exchange-ratio between commodities and money is everywhere the same. But men and their wants are not everywhere the same, and neither are commodities.[6]

If the tendency of the purchasing power of money is to be everywhere the same, what happens if one or more moneys coexist in the world? By way of explanation, Mises developed the Ricardian analysis into what was to be called the purchasing-power-parity theory of exchange rates, namely, that the market exchange rate between two independent moneys will tend to equal the ratio of their purchasing powers. Mises showed that this analysis applies both to the exchange rate between gold and silver—whether or not the two circulate side by side within the same country—and to independent fiat currencies issued by two nations. Wu explained the difference between Mises's theory and the unfortunately better-known version of the purchasing-power-parity theory set forth a bit later by Gustav Cassel. The Cassel version ignores the Austrian emphasis on locational differences in accounting for differences in value of technologically similar goods, and this in turn complements the broader Austrian and

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[5]Chi-Yuen Wu, *An Outline of International Price Theories* (London: George Routledge and Sons, 1939), p. 126.

[6]Ibid., p. 234; Mises, *Theory of Money and Credit*, p. 178. Mises's development of the theory was independent of Senior's because the latter was only published in 1928 in *Industrial Efficiency and Social Economy* (New York, 1928), pp. 55–56; see Wu, *Outline of International Price Theories*, p. 127*n*.

classical position that the purchasing power of money is an array of specific goods. This contrasts with Cassel and the neoclassicists, who think of the purchasing power of money as the inverse of a unitary price level. Thus Wu stated:

> The purchasing power parity theory is that the rate of exchange would be in equilibrium when the "purchasing power of the moneys" is equal in all trading countries. If the term *purchasing power* refers to the power of purchasing commodities, which are not only similar in technological composition, but also in the same geographical situation, the theory becomes the classical doctrine of comparative value of moneys in different countries and is a sound doctrine. But unfortunately the term purchasing power in connection with the theory sometimes implies the reciprocal of the general price level in a country. While so interpreted the theory becomes that the equilibrium point of the foreign exchanges is to be found at the quotient between the price levels of the different countries. That is . . . an erroneous version of the purchasing power parity theory.[7]

Unfortunately, Cassel, instead of correcting the error in his concept of purchasing power, soon abandoned the full-parity doctrine in favor of a different and highly attenuated contention that only changes in exchange rates reflect changes in respective purchasing power—perhaps because of his desire to use measurement and index numbers in applying the theory.[8]

When he set out to apply the theory of marginal utility to the price of money, Mises confronted the problem that was later to be called "the Austrian circle." In short, when someone ranks eggs or beef or shoes on his value scale, he values these goods for their direct use in consumption. Such valuations are, of course, independent of and prior to pricing on the market. But people demand money to hold in their cash balances, not for eventual direct use in consumption, but precisely in order to exchange those balances for other goods that will be used directly. Thus, money is not useful in itself but because it has a prior exchange value, because it has been and therefore presumably will be exchangeable in terms of other goods. In

[7]Ibid., p. 250; Mises's formulation is in *Theory of Money and Credit*, pp. 179–88.

[8]See Wu, *Outline of International Price Theories*, pp. 251–60.

short, money is demanded because it has a pre-existing purchasing power; its demand not only is not independent of its existing price on the market but is precisely due to its already having a price in terms of other goods and services. But if the demand for, and hence the utility of, money depends on its pre-existing price or purchasing power, how then can that price be explained by the demand? It seems that any Austrian attempt to apply marginal utility theory to money is inextricably caught in a circular trap. For that reason mainstream economics has not been able to apply marginal utility theory to the value of money and has therefore gone off in multi-causal (or *non*-causal) Walrasian directions.

Mises, however, succeeded in solving this problem in 1912 in developing his so-called regression theorem. Briefly, Mises held that the demand for money, or cash balances, at the present time—say day X—rests on the fact that money on the previous day, day X –1, had a purchasing power. The purchasing power of money on day X is determined by the interaction on day X of the supply of money on that day and that day's demand for cash balances, which in turn is determined by the marginal utility of money for individuals on day X. But this marginal utility, and hence this demand, has an inevitable historical component: the fact that money has prior purchasing power on day X –1, and that therefore individuals know that this commodity has a monetary function and will be exchangeable on future days for other goods and services. But what then determined the purchasing power of money on day X –1? Again, that purchasing power was determined by the supply of, and demand for, money on day X –1, and that in turn depended on the fact that the money had purchasing power on day X –2. But are we not caught in an infinite regression, with no escape from the circular trap and no ultimate explanation? No. What we must do is to push the temporal regression to that point when the money commodity was not used as a medium of indirect exchange but was demanded purely for its own direct consumption use. Let us go back logically to the second day that a commodity, say gold, was used as a medium of exchange. On that day, gold was demanded partly because it has a pre-existing purchasing power as a money, or rather as a medium of exchange, on the first day. But what of that first day? On that day, the demand for gold again depended on the fact that gold had a previous purchasing power, and so we push the analysis back to the last day of barter. The demand for gold on the last day of barter was purely a consumption use and had no historical component referring to any previous day; for under barter, every commodity was demanded purely for its current consumption use, and gold was no different. On the first day of its use as a medium of exchange, gold began to have two components in its demand, or utility: first, a consumption use as had existed in barter and, second, a monetary use, or use as a medium of exchange, which had a historical component in its utility. In short, the demand for money can be pushed back to the last day of barter, at which point the temporal element in the demand for the money commodity disappears, and the causal forces in the current demand and purchasing power of money are fully and completely explained.

Not only does the Mises regression theorem fully explain the current demand for money and integrate the theory of money with the theory of marginal utility, but it also shows that money must have originated in this fashion—on the market—with individuals on the market gradually beginning to use some previously valuable commodity as a medium of exchange. No money could have originated either by a social compact to consider some previously valueless thing as a "money" or by sudden governmental fiat. For in those cases, the money commodity could not have a previous purchasing power, which could be taken into account in the individual's demands for money. In this way, Mises demonstrated that Carl Menger's historical insight into the way in which money arose on the market was not simply a historical summary but a theoretical necessity. On the other hand, while money had to originate as a directly useful commodity, for example, gold, there is no reason, in the light of the regression theorem, why such direct uses must continue afterward for the commodity to be used as money. Once established as a money, gold or gold substitutes can lose or be deprived of their direct use function and still continue as money; for the historical reference to a previous day's purchasing power will already have been established.[9]

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[9]Mises's regression theorem may be found in *Theory of Money and Credit*, pp. 97–123. For an explanation and a diagrammatic representation of the regression theorem, see Rothbard, *Man, Economy, and State*, pp. 231–37. Menger's insight into the origin of money on the market may be found in Carl Menger, *Principles of Economics* (Glencoe, Ill.: The Free Press,

In his comprehensive 1949 treatise, *Human Action*, Mises successfully refuted earlier criticisms of the regression theorem by Anderson and Ellis.[10] Subsequently criticisms were leveled at the theory by J.C. Gilbert and Don Patinkin. Gilbert asserted that the theory fails to explain how a new paper money can be introduced when the previous monetary system breaks down. Presumably he was referring to such examples as the German *Rentenmark* after the runaway inflation of 1923. But the point is that the new paper was not introduced *de novo*; gold and foreign currencies had existed previously, and the *Rentenmark* could and did undergo exchange in terms of these previously existing moneys; furthermore, it was introduced at a fixed relation to the previous, extremely depreciated mark.[11]

Patinkin criticized Mises for allegedly claiming that the marginal utility of money refers to the marginal utility of the goods for which money is exchanged rather than the marginal utility of holding money itself; he also charged Mises with inconsistently holding the latter view in the other parts of *The Theory of Money and Credit*. But Patinkin was mistaken; Mises's concept of the marginal utility of money always refers to the utility of holding money. Mises's point in the regression theorem is a different one, namely, that the marginal utility-to-hold is itself based on the prior fact that money can be exchanged for goods, that is, on the prior purchasing power of money in terms of goods. In short, money prices of goods, the purchasing power of money, has first to exist in order for money to have a marginal utility to hold, hence the need for the regression theorem to break out of the circularity.[12]

Modern orthodox economics has abandoned the quest for causal explanation in behalf of a Walrasian world of "mutual determination"

1950), pp. 257–62. On the relationship between Menger's approach and the regression theorem, see Mises, *Human Action*, pp. 402–04.

[10]Mises, *Human Action*, pp. 405–07. The regression analysis was either adopted by or arrived at independently by William A. Scott in *Money and Banking,* 6th ed. (New York: Henry Holt, 1926), pp. 54–55.

[11]J.C. Gilbert, "The Demand for Money: The Development of an Economic Concept," *Journal of Political Economy* 61 (April 1953): 149.

[12]Don Patinkin, *Money, Interest, and Prices* (Evanston, Ill.: Row, Peterson, 1956), pp. 71–72, 414.

suitable for the current fashion of mathematical economics. Patinkin himself feebly accepted the circular trap by stating that in analyzing the market ("market experiment") he began with utility while in analyzing utility he began with prices ("individual experiment"). With characteristic arrogance, Samuelson and Stigler each attacked the Austrian concern with escaping circularity in order to analyze causal relations. Samuelson fell back on Walras, who developed the idea of "general equilibrium in which all magnitudes are simultaneously determined by efficacious interdependent relations," which he contrasted to the "fears of literary writers" (that is, economists who write in English) about circular reasoning.[13]

Stigler dismissed Böhm-Bawerk for his

> failure to understand some of the most essential elements of modern economic theory, the concepts of mutual determination and equilibrium (developed by the use of the theory of simultaneous equations). Mutual determination . . . is spurned for the older concept of cause and effect.

Stigler added the snide note that "Böhm-Bawerk was not trained in mathematics."[14]

Thus, orthodox economists reflect the unfortunate influence of the mathematical method in economics. The idea of mutual functional determination—so adaptable in mathematical presentation—is appropriate in physics, which tries to explain the unmotivated motions of physical matter. But in praxeology, the study of human action, of which economics is the best elaborated part, the cause is known: individual purpose. In economics, therefore, the proper method is to proceed from the causing action to its consequent effects.

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[13]Paul A. Samuelson, *Foundations of Economic Analysis* (Cambridge, Mass.: Harvard University Press, 1947), pp. 117–18.

[14]George Stigler, *Production and Distribution Theories: The Formative Period* (New York: Macmillan, 1946), p. 181; also see the similar, if more polite, attack on Menger by Frank H. Knight, "Introduction," in Menger, *Principles*, p. 23. For a contrasting discussion by the mathematical economist son of Menger, Karl Menger, see "Austrian Marginalism and Mathematical Economics," in *Carl Menger and the Austrian School of Economics*, John R. Hicks and Wilhelm Weber, eds. (Oxford: Clarendon Press, 1973), pp. 54–60.

In *Human Action*, Mises advanced the Austrian theory of money by delivering a shattering blow to the very concept of Walrasian general equilibrium. To arrive at that equilibrium, the basic data of the economy—values, technology, and resources—must all be frozen and understood by every participant in the market to be frozen indefinitely. Given such a magical freeze, the economy would sooner or later settle into an endless round of constant prices and productions, with each firm earning a uniform rate of interest (or, in some construction, a zero rate of interest). The idea of certainty and fixity in what Mises called "the evenly rotating economy" is absurd, but what Mises went on to show is that in such a world of fixity and certainty no one would hold cash balances. For since everyone would have perfect foresight and knowledge of his future sales and purchases, there would be no point in holding any cash balance at all. Thus, the man who knew he would be spending $5,000 on 1 January 1977 would lend out all his money to be returned at precisely that date. As Mises stated:

> Every individual knows precisely what amount of money he will need at any future date. He is therefore in a position to lend all the funds he receives in such a way that the loans fall due on the date he will need them. . . . When the equilibrium of the evenly rotating economy is finally reached, there are no more cash holdings.[15]

But if no one holds cash and the demand for cash balances falls to zero, all prices rise to infinity, and the entire general equilibrium system of the market, which implies the continuing existence of monetary exchange, falls apart. As Mises concluded:

> In the imaginary construction of an evenly rotating economy, indirect exchange and the use of money are tacitly implied. . . . Where there is no uncertainty concerning the future, there is no need for any cash holding. As money must necessarily be kept by people in their cash holdings, there cannot be any money. . . . But the very notion of a market economy without money is self-contradictory.[16]

The very notion of a Walrasian general equilibrium is not simply totally unrealistic, it is conceptually impossible, since money and

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[15]Mises, *Human Action*, p. 250.

[16]Ibid., pp. 249–50, 414.

monetary exchange cannot be sustained in that kind of system. Another corollary contribution of Mises in this analysis was to demonstrate that, far from being only one of many "motives" for holding cash balances, uncertainty is crucial to the holding of any cash at all.

That such problems are now troubling mainstream economics is revealed by F.H. Hahn's demonstration that Patinkin's well-known model of general equilibrium can only establish the existence of a demand for money by appealing to such notions as an alleged uncertainty of the exact moments of future sales and purchases, and to "imperfections" in the credit market—neither of which, as Hahn pointed out, is consistent with the concept of general equilibrium.[17]

With respect to the supply of money, Mises returned to the basic Ricardian insight that an increase in the supply of money never confers any general benefit upon society. For money is fundamentally different from consumers' and producers' goods in at least one vital respect. Other things being equal, an increase in the supply of consumers' goods benefits society since one or more consumers will be better off. The same is true of an increase in the supply of producers' goods, which will be eventually transformed into an increased supply of consumers' goods; for production itself is the process of transforming natural resources into new forms and locations desired by consumers for direct use. But money is very different: money is not used directly in consumption or production but is exchanged for such directly usable goods. Yet, once any commodity or object is established as a money, it performs the maximum exchange work of which it is capable. An increase in the supply of money causes no increase whatever in the exchange service of money; all that happens is that the purchasing power of each unit of money is diluted by the increased supply of units. Hence there is never a social need for increasing the supply of money, either because of an increased supply of goods or because of an increase in population. People can acquire an increased proportion of cash balances with a fixed supply of money by spending less and thereby increasing the purchasing power

[17]F.H. Hahn, "On Some Problems of Proving the Existence of an Equilibrium in a Monetary Economy," in *The Theory of Interest Rates*, F.H. Hahn and F.P.R. Breckling, eds. (London: Macmillan, 1956), pp. 128–32.

of their cash balances, thus raising their real cash balances overall. As Mises wrote:

> The services money renders are conditioned by the height of its purchasing power. Nobody wants to have in his cash holding a definite number of pieces of money or a definite weight of money; he wants to keep a cash holding of a definite amount of purchasing power. As the operation of the market tends to determine the final state of money's purchasing power at a height at which the supply of and the demand for money coincide, there can never be an excess or a deficiency of money. Each individual and all individuals together always enjoy fully the advantages which they can derive from indirect exchange and the use of money, no matter whether the total quantity of money is great or small. Changes in money's purchasing power generate changes in the disposition of wealth among the various members of society. From the point of view of people eager to be enriched by such changes, the supply of money may be called insufficient or excessive, and the appetite for such gains may result in policies designed to bring about cash-induced alterations in purchasing power. However, the services which money renders can be neither improved nor impaired by changing the supply of money. . . . The quantity of money available in the whole economy is always sufficient to secure for everybody all that money does and can do.[18]

A world of constant money supply would be one similar to that of much of the eighteenth and nineteenth centuries, marked by the successful flowering of the Industrial Revolution with increased capital investment increasing the supply of goods and with falling prices for those goods as well as falling costs of production.[19] As demonstrated by the notable Austrian theory of the business cycle, even an inflationary expansion of money and credit merely offsetting the secular fall in prices will create the distortions of production that bring about the business cycle.

In the face of overwhelming arguments against inflationary expansion of the money supply (including those not detailed here),

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[18]Mises, *Human Action*, p. 418.

[19]On the advantages of a secularly falling price "level," see C.A. Phillips, T.F. McManus, and R.W. Nelson, eds., *Banking and the Business Cycle* (New York: Macmillan, 1937), pp. 186–88, 203–07.

what accounts for the persistence of the inflationary trend in the modern world? The answer lies in the way new money is injected into the economy, in the fact that it is most definitely not done according to the Angel Gabriel model. For example, a government does not multiply the money supply tenfold across the board by issuing a decree adding another zero to every monetary number in the economy. In any economy not on a 100 percent commodity standard, the money supply is under the control of government, the central bank, and the controlled banking system. These institutions issue new money and inject it into the economy by spending it or lending it out to favored debtors. As we have seen, an increase in the supply of money benefits the early receivers, that is, the government, the banks, and their favored debtors or contractors, at the expense of the relatively fixed income groups that receive the new money late or not at all and suffer a loss in real income and wealth. In short, monetary inflation is a method by which the government, its controlled banking system, and favored political groups are able to partially expropriate the wealth of other groups in society. Those empowered to control the money supply issue new money to their own economic advantage and at the expense of the remainder of the population. Yield to government the monopoly over the issue and supply of money, and government will inflate that supply to its own advantage and to the detriment of the politically powerless. Once we adopt the distinctively Austrian approach of "methodological individualism," once we realize that government is not a superhuman institution dedicated to the common good and the general welfare, but a group of individuals devoted to furthering their economic interests, then the reason for the inherent inflationism of government as money monopolist becomes crystal clear.

As the Austrian analysis of money shows, however, the process of generated inflation cannot last indefinitely, for the government cannot in the final analysis control the pace of monetary deterioration and the loss of purchasing power. The ultimate result of a policy of persistent inflation is runaway inflation and the total collapse of the currency. As Mises analyzed the course of runaway inflation (both before and after the first example of such a collapse in an industrialized country, in post-World War I Germany), such inflation generally proceeds as follows: At first the government's increase of the money supply and the subsequent rise in prices are regarded by the public as temporary. Since, as was true in Germany during World War I, the onset of inflation is often occasioned by the extraordinary expenses of a war, the public assumes that after the war conditions including prices will return to the pre-inflation norm. Hence the public's demand for cash balances rises as it awaits the anticipated lowering of prices. As a result, prices rise less than proportionately and often substantially less than the money supply, and the monetary authorities become bolder. As in the case of the Assignats during the French Revolution, here is a magical panacea for the difficulties of government: pump more money into the economy, and prices will rise only a little! Encouraged by the seeming success, the authorities apply more of what has worked so well, and the monetary inflation proceeds apace. In time, however, the public's expectations and views of the economic present and future undergo a vitally important change. They begin to see that there will be no return to the pre-war norm, that the new norm is a continuing price inflation—that prices will continue to go up rather than down. Phase two of the inflationary process ensues, with a continuing fall in the demand for cash balances based on this analysis: "I'd better spend my money on X, Y, and Z now, because I know full well that next year prices will be higher." Prices begin to rise more than the increase in the supply of money. The critical turning point has arrived.

At this point, the economy is regarded as suffering from a money shortage as evidenced by the outstripping of monetary expansion by the rise in prices. What is now called a liquidity crunch occurs on a broad scale, and a clamor arises for greater increases in the supply of money. As the Austrian school economist Bresciani-Turroni wrote in his definitive study of the German hyperinflation:

> The rise of prices caused an intense demand for the circulating medium to arise, because the existing quantity was not sufficient for the volume of transactions. At the same time the State's need of money increased rapidly . . . the eyes of all were turned to the Reichsbank. The pressure exercised on it became more and more insistent and the increase of issues, from the central bank, appeared as a remedy. . . .
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> The authorities therefore had not the courage to resist the pressure of those who demanded ever greater quantities of paper money, and to face boldly the crisis which . . . would be, undeniably, the result of a stoppage of the issue of notes. They preferred to continue the convenient method of continually increasing the

> issues of notes, thus making the continuation of business possible, but at the same time prolonging the pathological state of the German economy. The Government increased salaries in proportion to the depreciation of the mark, and employers in their turn granted continual increases in wages, to avoid disputes, on the condition that they could raise the prices of their products. . . .
>
> Thus was the vicious circle established; the exchange depreciated; internal prices rose; note-issues were increased; the increase of the quantity of paper money lowered once more the value of the mark in terms of gold; prices rose once more; and so on. . . .
>
> For a long time the Reichsbank—having adopted the fatalistic idea that the increase in the note-issues was the inevitable consequence of the depreciation of the mark—considered as its principal task, not the regulation of the circulation, but the preparation for the German economy of the continually increasing quantities of paper money, which the rise in prices required. It devoted itself especially to the organization, on a large scale, of the production of paper marks.[20]

The sort of thinking that gripped the German monetary authorities at the height of the hyperinflation may be gauged from this statement by the president of the Reichsbank, Rudolf Havenstein:

> The wholly extraordinary depreciation of the Mark has naturally created a rapidly increasing demand for additional currency, which the Reichsbank has not always been able fully to satisfy. A simplified production of notes of large denominations enabled us to bring ever greater amounts into circulation. But these enormous sums are barely adequate to cover the vastly increased demand for the means of payment, which has just recently attained an absolutely fantastic level. . . .

[20]Costantino Bresciani-Turroni, *The Economics of Inflation* (London: George Allen and Unwin, 1937), pp. 80–82; also see Frank D. Graham, *Exchange, Prices, and Production in Hyper-inflation: Germany 1920–23* (New York: Russell and Russell, 1930), pp. 104–07. For an analysis of hyperinflation see Mises, *Theory of Money and Credit*, pp. 227–30; and idem, *Human Action*, pp. 423–25.

> The running of the Reichsbank's note-printing organization, which has become absolutely enormous, is making the most extreme demands on our personnel.[21]

The United States seems to be entering phase two of inflation (1975), and it is noteworthy that economists such as Walter Heller have already raised the cry that the supply of money must be expanded in order to restore the real cash balances of the public, in effect to alleviate the shortage of real balances. As in Germany in the early 1920s, the argument is being employed that the quantity of money cannot be the culprit for inflation since prices are rising at a greater rate than the supply of money.[22]

Phase three of the inflation is the ultimate runaway stage: the collapse of the currency. The public takes panicky flight from the money into real values, into any commodity whatever. The public's psychology is not simply to buy now rather than later but to buy anything immediately. The public's demand for cash balances hurtles toward zero.

The reason for the enthusiasm of Mises and other Austrian economists for the gold standard, the purer and less diluted the better, should now be crystal clear. It is not that this "barbaric relic" has any fetishistic attraction. The reason is that a money under the control of the government and its banking system is subject to inexorable pressures toward continuing monetary inflation. In contrast, the supply of gold cannot be manufactured *ad libitum* by the monetary authorities; it must be extracted from the ground, by the same costly process as governs the supply of any other commodities on the market. Essentially the choice is: gold or government. The choice of gold rather than other market commodities is the historical experience of centuries that gold (as well as silver) is uniquely suitable as a monetary commodity—for reasons once set forth in the first chapter of every money-and-banking textbook.

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[21]Rudolf Havenstein, Address to the Executive Committee of the Reichsbank, 25 August 1923, translated in *The German Inflation of 1923*, Fritz K. Ringer, ed. (New York: Oxford University Press, 1969), p. 96.

[22]See Denis S. Karnofsky, "Real Money Balances: A Misleading Indicator of Monetary Actions," *Federal Reserve Bank of St. Louis Review* 56 (February 1974): 2–10.

The criticism might be made that gold, too, can increase in quantity, and that this rise in supply, however limited, would also confer no benefit upon society. Apart from the gold versus government choice, however, there is another important consideration: an increase in the supply of gold improves its availability for nonmonetary uses, an advantage scarcely conferred by the fiat currencies of government or the deposits of the banking system.

In contrast to the Misesian "monetary overinvestment" theory of business cycles, on which considerable work has been done by F.A. Hayek and other Austrian economists, almost nothing has been done on the theory of money proper except by Mises himself. There are three cloudy and interrelated areas that need further elaboration. One is the route by which money can be released from government control. Of primary importance would be the return to a pure gold standard. To do so would involve, first, raising the "price of gold" (actually, lowering the definition of the weight of the dollar) drastically above the current pseudo-price of $42.22 an ounce and, second, a deflationary transformation of current bank deposits into nonmonetary savings certificates or certificates of deposit. What the precise price or the precise mix should be is a matter for research. Initially, the Mises proposal for a return to gold at a market price and the proposal of such Austrian monetary theorists as Jacques Rueff and Michael Heilperin for a return at a deliberately doubled price of $70 an ounce seemed far apart. But the current (1975) market price of approximately $160 an ounce brings the routes of a deliberately higher price and the market price much closer together.[23]

A second area for research is the matter of free banking as against 100 percent reserve requirements for bank deposits in relation to gold. Mises's *Theory of Money and Credit* was one of the first works to develop systematically the way in which the banks create money through an expansion of credit. It was followed by Austrian economist C.A. Phillips's famous distinction between the expansionary powers of individual banks and those of the banking system as a

[23]Mises's proposal is in *Theory of Money and Credit*, pp. 448–57; also see Michael A. Heilperin, *Aspects of the Pathology of Money* (Geneva: Michael Joseph, 1968); and Jacques Rueff, *The Monetary Sin of the West* (New York: Macmillan, 1972).

whole. However, one of Mises's arguments has remained neglected: that under a regime of free banking, that is, where banks are unregulated but held strictly to account for honoring their obligations to redeem notes or deposits in standard money, the operations of the market check monetary expansion by the banks. The threat of bank runs, combined with the impossibility of one bank's expanding more than a competitor, keeps credit expansion at a minimum. Perhaps Mises underestimated the possibility of a successful bank cartel for the promotion of credit expansion; it seems clear, however, that there is less chance for bank-credit expansion in the absence of a central bank to supply reserves and to be a lender of last resort.[24]

Finally, there is the related question, which Mises did not develop fully, of the proper definition of the crucial concept of the money supply. In current mainstream economics, there are at least four competing definitions, ranging from M1 to M4. Of one point an Austrian is certain: the definition must rest on the inner essence of the concept itself and not on the currently fashionable but question-begging methodology of statistical correlation with national income. Leland Yeager was trenchantly critical of such an approach:

> One familiar approach to the definition of money scorns any supposedly *a priori* line between money and near-moneys. Instead, it seeks the definition that works best with statistics. One strand of that approach . . . seeks the narrowly or broadly defined quantity that correlates most closely with income in equations fitted to historical data. . . . But it would be awkward if the definition of money accordingly had to change from time to time and country to country. Furthermore, even if money defined to include certain near-moneys does correlate somewhat more closely with income than money narrowly defined, that fact does not necessarily impose the broad definition. Perhaps the amount of these near-moneys depends on the level of money-income and in turn on the amount of medium of exchange. . . . More generally, it is not obvious why the magnitude with which some other magnitude correlates most closely deserves overriding attention. . . . The number of bathers at a beach may correlate more closely with the number of cars parked there than with either the temperature or the price of admission, yet the former correlation may be less interesting or useful than either of the latter. The correlation with national

[24]See Mises, *Human Action*, pp. 431–45.

> income might be closer for either consumption or investment than for the quantity of money.[25]

Money is the medium of exchange, the asset for which all other goods and services are traded on the market. If a thing functions as such a medium, as final payment for other things on the market, then it serves as part of the money supply. In his *Theory of Money and Credit*, Mises distinguished between standard money (money in the narrow sense) and money substitutes, such as bank notes and demand deposits, which function as an additional money supply. It should be noted, for example, that in Irving Fisher's non-Austrian classic, *The Purchasing Power of Money*, written at about the same time (1913), M consisted of standard money only, while M1 consisted of money substitutes in the form of bank demand deposits redeemable in standard at par. Today no economist would think of excluding demand deposits from the definition of money. But if we ponder the problem, we see that if a bank begins to fail, its deposits are no longer equivalent to money; they no longer serve as money on the market. They are only money until a bank's imminent collapse.

Furthermore, in the same way that M1 (currency plus demand deposits) is broader than the narrowest definition, we can establish even broader definitions by including savings deposits of commercial banks, and cash surrender values of life insurance companies, which are all redeemable on demand at par in standard money, and therefore all serve as money substitutes and as part of the money supply until the public begins to doubt that they are redeemable. Partisans of M1 argue that commercial banks are uniquely powerful in creating deposits and, further, that their deposits circulate more actively than the deposits of other banks. Let us suppose, however, that in a gold-standard country, a man has some gold coins in his bureau and others locked in a bank vault. His stock of gold coins at home will circulate actively and the ones in his vault sluggishly, but surely both are part of his stock of cash. And, if it also be objected that the deposits of savings banks and similar institutions pyramid on top of commercial bank deposits, it should also be noted that the latter in turn pyramid on top of reserves and standard money.

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[25] Leland B. Yeager, "Essential Properties of the Medium of Exchange," *Kyklos* (1968), reprinted in *Monetary Theory*, R.W. Clower, ed. (London: Penguin Books, 1969), p. 38.

Another example will serve to answer the common objection that a savings bank deposit is not money because it cannot be used directly as a medium of exchange but must be redeemed in that medium. (This is apart from the fact that savings banks are increasingly being empowered to issue checks and open up checking accounts.) Suppose that, through some cultural quirk, everyone in the country decided not to use five-dollar bills in actual exchange. They would only use ten-dollar and one-dollar bills, and keep their longer-term cash balances in five-dollar bills. As a result, five-dollar bills would tend to circulate far more slowly than the other bills. If a man wanted to spend some of his cash balance, he could not spend a five-dollar bill directly; instead, he would go to a bank and exchange it for five one-dollar bills for use in trade. In this hypothetical situation, the status of the five-dollar bill would be the same as that of the savings deposit today. But while the holder of the five-dollar bill would have to go to a bank and exchange it for dollar bills before spending it, surely no one would say that his five-dollar bills were not part of his cash balance or of the money supply.

A broad definition of the money supply, however, excludes assets not redeemable on demand at par in standard money, that is, any form of genuine time liability, such as savings certificates, certificates of deposit whether negotiable or nonnegotiable, and government bonds. Savings bonds, redeemable at par, are money substitutes and hence are part of the total supply of money. Finally, just as commercial bank reserves are properly excluded from the outstanding supply of money, so those demand deposits that in turn function as reserves for the deposits of these other financial institutions would have to be excluded as well. It would be double counting to include both the base and the multiple of any of the inverted money pyramids in the economy.

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Money, the State, and Modern Mercantilism

Money is the nerve center of any economy above the most primitive level. An economy consists of a vast and intricate network of two-person exchanges, and money constitutes one side of every exchange. Money is the medium by which producers of goods and services (sold for money) proceed to become consumers of goods and services (bought for money). If any one person or organization manages to obtain control over the supply of money—over its quality, its quantity, or its use—he or it has thereby taken a long step toward gaining complete control of the entire economic system. Similarly, it is difficult to see how complete economic control could be achieved without domination of the supply of money.

Money on the Free Market

In the purely free market, no one person or group can have control over money. Money arises, on the free market, when one or more commodities, in particularly intense demand and possessing such other qualities as durability, portability, and divisibility, are chosen by individuals to serve as media of exchange. Once a commodity begins to be used as a medium, the process accelerates as this makes the good all the more valuable, until it finally comes to be used as a general medium for exchanges—as a money. Over the centuries of civilization, gold and silver have been the leading commodities to be thus established as moneys. On the free market, then, money arises as another—and highly important—use for a commodity on the

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market; in the civilized era, these chosen commodities have been gold and silver.[1]

On the free market, a person can obtain money in only three ways: (a) by producing a good or service and exchanging it ("selling it") for the money-commodity; (b) by someone else's free gift; or (c) by producing the money-commodity itself. Route (b) will not be dominant in the economy and, at any rate, it reduces back to the other two methods, since at some point backward in time the gift process must come to an end. But a good will not be chosen on the market as money unless it is in long-lasting and great demand, and it cannot be in such demand unless it is relatively scarce. Therefore, route (c) for the acquisition of money involves the complicated production of a scarce commodity; in the case of gold and silver, it means finding new reserves of ore and extracting them from the ground. All businesses, all industries on the market, tend, in the long run, to yield about the same rate of return; if not, then capital and resources will flow out of the poorer earning and into the better earning industry until rates of return are equalized. Consequently, the gold-mining business will not provide any lasting bonanza on the market; it will tend to earn about the same rate of return as other industries. There will then be no *a priori* inducement to enter the gold- or silver-mining industry as compared to any other industry. Furthermore, gold and silver are so durable that the proportion of new gold or silver mined each year will generally be negligible compared to the existing stock.

The overwhelmingly important route to obtaining money on the market, then, will be route (a), the sale of goods and services for someone else's stock of money. No one will be able to obtain money unless he either produces goods or services for exchange or enters the gold-mining

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[1]Professor Mises has demonstrated that money can only originate in this way—as a commodity on the free market—and that it cannot originate by government fiat. See Ludwig von Mises, *The Theory of Money and Credit*, 2nd ed. (New Haven, Conn.: Yale University Press, 1953), pp. 97–123. For a further discussion, see Murray N. Rothbard, *Man, Economy, and State* (Princeton, N.J.: D. Van Nostrand, 1962), vol. 1, pp. 231–37. See also Rothbard, "The Case for a 100 Per Cent Gold Dollar," in *In Search of a Monetary Constitution*, Leland B. Yeager, ed. (Cambridge, Mass.: Harvard University Press, 1962).

business. Apart from voluntary gifts, he will receive gold or silver in proportion to the value that other exchangers put on his services to them.

It should be evident that, in the free-market economy, no one person or group will be able to control any aspect of society's money. All money is extracted from the ground by private individuals, and there is no issue of currency by the State. The total supply of money is determined by the state of natural resources and by people freely and voluntarily entering the gold- or silver-mining business. How much money each person gets is determined solely by every individual's free and voluntary decision on how much he will buy and sell, or not buy and sell, of any given product or service. The aggregate result of these individual choices determines a person's total sales and income. A free and uncontrolled money, and a free and uncontrolled market, go necessarily hand in hand.

And yet, curiously enough, so far has the world gone from a truly free money that even the most "conservative" economists, often champions of the free market in other areas, do not contemplate a return to free-market money. Milton Friedman and the economists of the "Chicago School" advocate, indeed, a totally fiat paper money, manufactured by government and cut loose entirely from any vestigial connection with gold and silver. The United States Chamber of Commerce, in its textbook series on economics, simply concedes: "Money is what the government says it is."[2] But surely no free market can endure when control over the vital supply of money is thus granted permanently to government.

Money and the State

In the *laissez-faire* revolution of the nineteenth century, money was one of the crucial areas where this revolution scarcely made headway. Government retained not only a mintage monopoly, legal tender laws, and the power to fix arbitrary exchange rates between gold and silver, but, particularly important, it retained its Central Bank, and thereby its virtual control over the banking system. Since the liabilities of the banking system, nominally redeemable in gold or silver, increasingly became the bulk of each country's money supply,

[2]Economic Research Department, Chamber of Commerce of the United States, *The Mystery of Money* (Washington, D.C.: Chamber of Commerce, 1953), p. 1.

governmental protection and domination of the banking system loomed as an ever more vital problem. The British classical liberals never even thought of disturbing the hallowed status of the Bank of England; the United States struggled intermittently with central banking. At other times, money was subject to other variants of government control. Having relinquished little of its monetary control in the nineteenth century, the State has, in the twentieth, moved to take over absolute control of the monetary system, seizing its subjects' gold and silver and preventing them from using these commodities as their money. In this way, in most countries, the State has arrogated to itself a monopoly of monetary issue; the "paper" standard, which forms the nation's money and on which the government-controlled and manipulated banking system issues its liabilities, is *government*-issued paper.

There is no mystery as to why the State clung to its control of money even while temporarily relinquishing its grip on other areas of the economy. For one thing, as we have seen, control over a nation's money is a prerequisite for dictation over the rest of the economy. Another reason for the State's vital interest in money is that only through such control can it break the production—income nexus of the free market. We have seen that, on the free market, the only way to obtain money is to produce and sell goods or services to those who wish to buy; thus, the only way to acquire money from other people is to provide them, *pari passu*, with services they desire. But there is one way to break the requirement of producing desired goods and services to obtain money; and that is to gain control of the means of *creating* money. If one can create new money simply and easily, then he can enter the market to consume goods and services without first having to produce any himself. On the market, private individuals cannot do this, since this constitutes the crime of "counterfeiting." The State, however, has the unique attribute of being able to perform actions which would be considered criminal on the part of private individuals ("taxation" as against "robbery"; "war" as against "murder"; "inflation" as against "counterfeiting"). If the State controls the money supply, then it can create new money and use it to increase its own expenditures on goods and services, as well as the expenditures of its favored, subsidized groups in society. The "legalized counterfeiting" of "monetary issue" permits the State to break the production—monetary income chain to its own advantage. Necessarily, this also means to the detriment of the actual producers in society, who must yield resources to the bidding of those who come to the marketplace equipped with this newly issued money. This is why "inflation"—the increase of paper money or bank liabilities—is a hidden, and therefore particularly insidious, form of taxation. Being hidden, an inflation of money is not likely to arouse the opposition that may be stirred by overt taxation. And since monetary inflation is hidden even while its consequence in rising prices becomes generally evident, the government can join the public in denouncing rising prices, while conveniently overlooking its own total responsibility for them. Indeed, it may go a step further; it may denounce any and all groups in the population, whose selling prices naturally rise during an inflation, for wickedly *causing* the price rise. Foreigners, speculators, businessmen (big or little), laborers—whichever scapegoats may be convenient are denounced, and then the government may go on to use these very attacks as a *point d'appui* for extending its controls and dictates over the society.

In short, the State may obtain its revenues—may break the production—income link of the market—in two ways. It may impose taxation, which is overt, evidently coercive, and likely to stir opposition if pressed too hard. Or, on the other hand, it may obtain control of the monetary system, and then create new money to spend for itself or to use for rewarding the groups it favors. Moreover, as we said above, this latter inflationary process is hidden and subtle, and thus not likely to arouse the general public; indeed the State can turn inflation to its own advantage by taking the lead in denouncing groups it happens to oppose for causing inflation and may then use this as an excuse to extend its own power. The State then emerges before the public, not as a predator heavily taxing the public, but as society's diligent protector against "inflation."

We may see now the irony in the doctrine that the State should "protect society against inflation" or "stabilize the price level." For inflation is the health of the State; it is the natural tendency of the State; and it is largely to enable it to inflate for its own benefit that the State is so determined to secure absolute control over the monetary mechanism.[3] Any group, in fact, that is given the exclusive

[3]As Wilhelm Röpke says, "Inflation is as old as the power of government over money." See his *A Humane Economy* (Chicago: Regnery, 1960),

power to create new money may be expected to use that power to its own advantage—and the State is surely no exception. It is curious how differently persons' motives are analyzed and judged when they are private individuals and when they are members of the State apparatus. When a man enters business or joins the labor force, few people assume that his prime motivation is the public weal rather than private profit or income, nor are they shocked that this is so. And yet, while personal gain is considered a natural motive in private enterprise, the moment a man enters the State apparatus he is assumed to be motivated purely by altruistic striving for the "public good," and any other motivation is considered "corrupt." Perhaps this is because the public realizes instinctively that, on the free market, private gain is earned by serving others, so that the private gain of one is consistent with, and indeed advances, the private gain of all. The public may also instinctively feel, on the other hand, that the State apparatus earns its gains only *at the expense* of others. In contrast to the harmony of interests on the market, there is an inherent conflict of interest implicit in State actions. Therefore, to believe that State officials confiscate and rule the property of others for their own private gain would be intolerable. To cloak the actions of the State in morally and aesthetically respectable forms, then, the public must believe that these actions are motivated by zeal for the "common good." Let the public see the fallacy of these assumptions, and view the State as a group of people battening off the production of others, and they are much more likely to see the State as a natural inflator than as an ideal instrument for "stabilizing the price level."

Central Banking

No institution is more necessary for State control and manipulation of a modern economy than the Central Bank, and no institution is more venerated. Most conservative economists believe themselves to be daring when they advocate independence of the Central Bank from the Treasury—a vain pretense that an organ of the State like

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p. 196. All manner of groups, at any given time or place, may become favorites or allies of the State; business, farm, labor, religious groups, and so on. The point is that (1) any group may try to use the State apparatus as a way of obtaining wealth or power for itself; and (2) the full-time rulers of the State will try to secure subsidized allies among the public.

the Central Bank can somehow be transformed into a wise and beneficent institution, "above politics." The wisdom of Federal Reserve manipulation of the American economy, for example, goes virtually unchallenged. The Chamber of Commerce, for one, has no doubt:

> It . . . is . . . an important function of the central banking authorities to determine the proper size of the money supply for the effective functioning of the economy and to try to pursue policies which will keep the money supply from either being over—or under—expanded.
>
> During recession and depression periods, the Federal Reserve should lower reserve requirements, buy U.S. Government securities and lower rediscount rates. This will provide commercial banks with excess reserves and tend to increase the supply of money. . . . During periods of prosperity and in the latter stages of recovery, the Federal Reserve should pursue the opposite of its depression policies: namely, it should raise reserve requirements, sell U.S. Government bonds, and raise rediscount rates. This puts a definite curb on the amount of credit which can be created and can act as a lever to prevent a boom from getting out of hand and can curb rising prices. . . .
>
> The power to prevent inflation (and to some extent deflation) unquestionably is now at hand in the U.S. Treasury and the Federal Reserve System. Enlightened public support on the side of reasonable price stability is indispensable to strengthen the hand of these monetary authorities.[4]

It is a generally accepted myth that the Federal Reserve System—as in the case of other central banks—was established to stabilize the economy and check inflation. Actually, it was designed to

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[4]*The Mystery of Money*, p. 17; Economic Research Department, Chamber of Commerce of the United States, *Control of the Money Supply* (Washington, D.C.: Chamber of Commerce, 1953), pp. 15, 21. The enthusiasm for Federal Reserve control by leading members of the gold standard group, the Economists' National Committee on Monetary Policy, is a case in point. See also the remarks of Professors Niehaus, Wiegand, and Spahr in *A Proper Monetary and Banking System for the United States*, James Washington Bell and Walter Earl Spahr, eds. (New York: Ronald Press, 1960), pp. 51, 106, 165.

promote inflation under the aegis of the central government. Individual banks by themselves, not artificially bolstered by central banks, have a tendency to collapse before they can inflate very far: either from each expanding bank's losing cash (gold or paper) to other banks, or from runs on the banks. The Central Bank can make sure that all banks expand together, can furnish needed reserves to banks throughout the country and lend to banks in trouble, and can thereby bring about a much greater, and centrally coordinated, expansion of the money supply.[5]

In refreshing contrast to the plethora of conservative economists who concede the need for the absolute control of the Federal Reserve over our money is a perceptive and unequivocating article of Oscar B. Johannsen. Beginning with a critique of a report by the Economic Policy Commission of the American Banker's Association, Mr. Johannsen continues:

> the Commission apparently accepts without question the fundamental principle that money, banking and credit revolve around the State and that the State must, therefore, control monetary affairs through political action. . . . It is no more a function of the State to regulate money and banking than it is a function of the State to regulate growing and marketing of onions. . . . In keeping with the trend to intervene in the social sciences, the State has, to the limit that it could, gathered money, banking and credit together into one centralized banking system controlled by itself. But a governmentally centralized banking system is a socialized banking system, as the essence of socialism is the control and direction by the government of that which should be private enterprise.
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> It should be apparent now that with the inception of the Federal Reserve System, America adopted a system dealing with a phase of private enterprise totally different from that under which most other businesses are conducted. Manufacturing, mining,

[5]For an excellent discussion of the inflationary nature of the Federal Reserve System, as well as its further inflationary policies and their disastrous consequences, see C.A. Phillips, T.F. McManus, and R.W. Nelson, *Banking and the Business Cycle* (New York: Macmillan, 1937), pp. 21ff.; also O.K. Burrell, "The Coming Crisis in External Convertibility in U.S. Gold," *The Commercial and Financial Chronicle* (April 23, 1959): 5.

> trade are carried on by private individuals all seeking to make a profit with the customer as King. No arbitrary commission, or group of men, or bureaucrats determines who shall make cars, what cars shall be made, what prices shall be asked. . . . This is all done by private individuals, and they are guided by King Customer, who directs them by buying or not buying. Unfortunately, in banking, which has as its principal raw material the most important of all commodities—money—we have adopted socialism. This is an alarming fact upon which private enterprise cannot look with equanimity, as a socialized banking system is the precursor of socialism in all business.[6]

Inflationism and Mercantilism in America: Five Case Studies in Historical Revision

If inflation is the health of the State, how and in what way has government generated inflation in the history of the United States? The following case studies illustrate this process, as well as the important connection between inflation and centralized State control of the economy. They illustrate also the connection of inflation with mercantilism—the use of economic regulation and intervention by the State to create special privileges for a favored group of merchants or businessmen. Until very recently, conservative as well as left-wing historians have accepted the neo-Marxian myth that struggles over inflation and hard money in America have all been "class struggles" of the farmers and workers ("debtor classes") in favor of inflation, as against merchant-creditors on behalf of hard money. The case studies indicate how recent historical scholarship has refuted this widely accepted thesis.

The Massachusetts Land Bank of 1740

One inflationist paper-money scheme, the Massachusetts Land Bank of 1740, has generally been regarded by historians as a plan instituted by a mass of small farmer-debtors, over the opposition of the merchant-creditors of Boston. This stereotype was first fashioned by the contemporary opponents of the plan, who dismissed

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[6]Oscar B. Johannsen, "Advocates Unrestricted Private Control Over Money and Banking," *The Commercial and Financial Chronicle* (June 12, 1958): 2622.

the proponents of the bank as "plebeians"; it was systematized by such conservative economic historians as Andrew M. Davis, writing at a time when agrarian Populist inflationism was a threat to sound finance, and then taken over by neo-Marxist historians in the 1930s, to become established in the history textbooks. Actually, as Dr. Billias has shown in an important paper, the major proponents of the plan were as wealthy and as connected with business as its opponents; merchants were debtors too, and the chief advocates of a land bank "were all businessmen, politicians, or professional men residing in Boston"; the leading proponent of the plan was John Colman, a prominent Boston merchant and the founder of the Massachusetts Land Bank. Colman, indeed, tried to stir up support among the farmers by promising them that the inflation arising from the establishment of the bank would raise the prices of farm products. Businessmen were particularly eager for inflation after 1720, because after that date the Massachusetts government adopted a policy of granting unsettled frontier land to speculators, who then sold these lands to the actual settlers at far higher prices. Expanded bank credit was wanted to finance business speculation in government land grants as well as to raise land prices. Joined with inflation was another mercantilist feature: a subsidy to home manufacturing, through permitting repayment of bank debts in certain specified manufactured commodities.[7]

Nicholas Biddle, Planner and Central Banker

The famous Bank War between Andrew Jackson and the Second Bank of the United States has also suffered grievous misinterpretation by historians. Jackson has been considered a wild-eyed agrarian inflationist, out to wreck conservative "sound finance," as represented by Nicholas Biddle, head of the Bank. Here, again, this interpretation began with Jackson's contemporary enemies, was forged amidst conservative battles with agrarian Populists in the late nineteenth century, and then was adopted—with heroes and villains, of course, reversed—by the neo-Marxist historians of the 1920s and 1930s. Actually, as recent historians have pointed out, the true ancestor of the New Deal was not Andrew Jackson but his opponents, including

[7]George Athan Billias, "The Massachusetts Land Bankers of 1740," *University of Maine Bulletin* (April 1959).

Nicholas Biddle. Biddle, son of a leading merchant of Philadelphia, enthusiastically embraced the mercantilist "American System" of the Whigs. Biddle's mercantilist views emerge clearly from the eulogistic biography by Professor Govan, who writes:

> Biddle's study of political economy led him to reject the doctrines of the classical liberals. . . . He had seen too clearly during the course of the War of 1812 and its aftermath how business activity responded to the expansion and contraction of the money supply to believe that economic activity was governed by natural laws with which men interfered at their peril. He advocated a protective tariff for national reasons, primarily to free the country from economic domination by England. . . . Wages and profits of workers and factory owners could be maintained at higher levels than the world outside, and farmers and merchants would receive recompense in the large and constantly increasing home market. . . . Internal improvements and a national bank were essential elements in such a program. The construction of roads and canals and the improvement of rivers and harbors would facilitate the movement of goods and people, and the Bank of the United States, by providing a uniform currency and regulating the rates of domestic exchange, would similarly facilitate the pecuniary aspects of these same transactions.
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> No single mind created this concept of a predominantly private economy which was directed, supported, and controlled in the public interest by responsible national authorities. Its origin was the state papers of Alexander Hamilton.[8]

Stephen Colwell, Conservative Socialist

The neglected mercantilistic affinities of conservatism and socialism have never been better illustrated than in the case of a leading protectionist ideologue of the first half of the nineteenth century, Stephen Colwell.[9] Colwell was an important Pennsylvania ironmaster and was

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[8]Thomas Payne Govan, *Nicholas Biddle: Nationalist and Public Banker, 1786–1844* (Chicago: University of Chicago Press, 1959), pp. 70–71; cf. pp. 50, 65.

[9]For an illuminating discussion of Colwell, see Joseph Dorfman, *The Economic Mind in American Civilization* (New York: Viking Press, 1946), vol. 2, pp. 809–26.

prominent in railroad investments. Iron manufacture, of course, was always a leading beneficiary of the protective tariff and of bank credit expansion as well.[10] In a series of articles published during the 1840s in the Presbyterian Biblical Repertory and Princeton Review, Colwell "attempted to weld together in the name of Christianity the pro-slavery, the high-tariff, pro-bank, and anti-democratic forces of the nation."[11] Colwell fulminated against the "moneyed power" (commerce), which "must be regulated by a judicious tariff or it will consult its own greedy interest, regardless of the sufferings it imposes on labor in the process," the laborer, "crushed, starved, and cast aside by bitter competition," is a worse "slave" than the slave in the South.[12] In fact, the slave benefits from slavery and would benefit still more from high tariffs. A wise and proper protective tariff would also enable men to fix prices not cheaply, but with reference to the quantity of labor expended on the product. *Laissez-faire* was denounced by Colwell as abstract and as emphasizing selfishness and materialism rather than religion, morals, history, and the well-being of the whole man The *laissez-faire* theorists, in fact, wickedly placed the "claims of free trade" higher than the "claims of labor," which include the protection and discipline of the slave system.[13] Colwell also wrote "The government alone can survey the whole field of national industry and ascertain the condition of all the laborers how many are suffering from the influx of foreign products."

In the 1850s Colwell concentrated on denunciation of hard money, a call for a central bank to regulate the currency, and demand for inconvertible paper money. In fact, under Colwell's scheme, banks would not have to redeem their notes, being obligated only to receive their own notes in repayments of debt. Colwell denied that

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[10]The first prominent political leader of the organized protectionist movement in America, Representative Henry Baldwin, was a prominent Pittsburgh iron manufacturer. Baldwin, indeed, was dubbed the "Father of the American System." See Murray N. Rothbard, *The Panic of 1819: Reactions and Policies* (New York: Columbia University Press, 1962), pp. 164ff.

[11]Dorfman, *The Economic Mind in American Civilization*, p. 811.

[12]Ibid., pp. 811–12.

[13]Cf. Stephen Colwell, *The Claims of Labor and Their Precedence to the Claims of Free Trade* (1861).

his contemplated inflation would increase prices greatly: the quantity theory of money was the product of "theorists" and was disproved by statistics. And anyway, high prices, even if they do follow, are beneficial, especially if joined with a high tariff to ensure that foreign competition will not disturb the idyll of high prices and high wages. Colwell denounced the banking system, with notes payable in specie, as "falsely predicated upon the assumption that whenever our importers, in consequence of having overtraded, must meet a heavily adverse balance, the business community as a whole should be denied its usual bank accommodation."[14]

Inflation and Protectionism in the Reconstruction Period

Another myth that has dominated the ranks of historians until very recently is the neo-Marxist Beard-Beale concept of the Reconstruction period as the exploitation of the defeated South by the "rising capitalist class" of the North. The "exploitation" was supposed to have been imposed largely through sound money and the protective tariff. Here again, historians were guilty of reading back ideological and political conditions that had been obtained only after 1890. In fact, as a few historians have recently demonstrated, the Northern capitalists were split in their opinion of the Reconstruction program, and the Radical Republicans themselves were split on the issues of sound money and the tariff. Of the two famous leaders of the Radicals, Senator Charles Sumner favored hard money and free trade, while Representative Thaddeus Stevens, Pennsylvania iron-master, favored protection and the greenbacks. Once again, the Pennsylvania iron and steel industry was in the forefront of the battle for protection and for greenback inflationism. The Pennsylvanians realized that, in a period of inconvertible greenback money, inflation—and the consequent depreciation of greenbacks compared to gold and foreign exchange—was the equivalent of a protective tariff, in its artificial cheapening of American exports and making dear of American imports. Representative William D. ("Pig Iron") Kelley of Pennsylvania was another leading devotee of greenback inflation and a protective tariff.

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[14]Harry E. Miller, *Banking Theories in the United States Before 1860* (Cambridge, Mass.: Harvard University Press, 1927), p. 138; cf. pp. 135–38.

The Pennsylvania iron and steel interests feared the lower-cost competition of Great Britain. They were joined in backing protection and greenbacks by the marginal Pennsylvania coal industry, which feared the import of low-cost, Nova Scotia coal, and by stock speculators such as Henry Clews, who desired inflationary credit for the financing of stock speculation and the raising of stock prices. Nor were the wealthy mercantilist partisans above the use of anti-capitalist rhetoric.

Stephen Colwell was again active in the cause. And Representative Daniel J. Morrell, a leading iron manufacturer from Pennsylvania, attacked the hard-money forces as "enemies of the workingman" and as "money men, who wish to give their money more power over labor and its products."[15] Joseph Wharton, of the Bethlehem Iron Company, accused the hard-money Treasury policy of resuming specie payment as being engineered "by our English enemies."[16] The cause of protection and inflation was also persistently backed by the American Iron and Steel Association, the Union Meeting of American Iron Masters, the American Industrial League (composed largely of Pennsylvania ironmasters) and its organ Industrial Bulletin, as well as the magazines *The American Manufacturer* (Pittsburgh) and *Iron Age*.

One of the leading advocates of cheap money during this period was the prominent banker Jay Cooke. Cooke, a recipient of government land grants in his railroad ventures, benefited from inflation and credit expansion that drove up the price of land. Incidentally, Cooke had been a driving force behind the creation of the National Banking System during the Civil War, an innovation which brought federal control over the banking system for the first time since Jackson's abolition of the Second Bank of the United States. Cooke was hired by the North to be the leading underwriter of government bonds, and he thereupon worked for the establishment of a national banking system whose reserves would rest on government bonds, thus forcing the banks to invest heavily in (Cooke's) bonds.[17]

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[15]Robert P. Sharkey, *Money, Class, and Party* (Baltimore, Maryland: Johns Hopkins University Press, 1959), p. 159*n*.

[16]Irwin Unger, "Business Men and Specie Resumption," *Political Science Quarterly* (March 1959): 53.

[17]Sharkey, *Money, Class, and Party*, pp. 245ff. For other works of historical revision on this topic, see, in addition to Unger, "Business Men and

Paul Warburg, the Acceptance Market and the Federal Reserve System

From its inception the Federal Reserve System, curiously enough, set out to create a market for acceptance paper, a form of credit that scarcely existed in this country (in contrast to Europe). It was uneconomical in the United States, where credit channels preferred another form entirely: single-name promissory notes. Yet the "Fed" granted an enormous subsidy to the acceptance market by standing ready to buy any acceptances offered by the market—and at a specially favorable price, cheaper than the Federal Reserve's ordinary rediscounts. This policy of unconditional support and subsidy of the acceptance market proved disastrous in the boom of the late 1920s, several times preventing the Federal Reserve from halting its expansion of credit. During the late 1920s the Federal Reserve, purchasing acceptances in this way directly from private acceptance banks, came to hold almost half of the bankers' acceptances outstanding in the country.[18] Furthermore, it confined its generous subsidy policy to a few large acceptance houses. It refused to buy acceptances directly from business, insisting on purchasing them from intermediary acceptance houses, and from only those with a capital of over $1 million. It also granted a few large dealers "repurchase agreements"—the option to buy back the acceptances at the current price.

What was the reason for this policy, which proved highly inflationary, failed in the ultimate attempt to create a permanent and widespread acceptance market, and constituted a flagrant form of subsidy and special privilege to the major acceptance banks? Perhaps the reason centers around the leading role played in the creation of

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Specie Resumption," pp. 46–70; Stanley Coben, "Northeastern Business and Radical Reconstruction: A Re-examination," *Mississippi Valley Historical Review* (June 1959): 67–90; Irwin Unger, "Review of Robert P. Sharkey, *Money, Class and Party*," *Political Science Quarterly* (June 1960); and Julius Grodinsky, "Review of Robert P. Sharkey," *Mississippi Valley Historical Review* (June 1960).

[18]See Charles O. Hardy, *Credit Policies of the Federal Reserve System* (Washington, D.C.: Brookings Institution, 1932), pp. 243–63. Hardy was certainly correct in concluding (p. 263) that "Nothing has been gained by forcing the acceptance form of credit into uses in which it cannot compete on its own merits."

the Federal Reserve System by Paul M. Warburg, one of the system's founders. Warburg came from Germany, where central banking was well established, to become a partner in the investment banking house of Kuhn, Loeb, and Company, and promptly embarked on a campaign on behalf of central banking in the United States.

Warburg was named first chairman of the Federal Reserve Board. After the war and during the 1920s he continued to be chairman of the influential Federal Advisory Council, a statutory group of bankers advising the Federal Reserve System. Interestingly enough, Warburg also became one of the nation's leading acceptance bankers, thus benefiting greatly from the system he helped found and whose course he helped set. He was Chairman of the Board of International Acceptance Bank of New York, the world's largest acceptance bank, was a director of the important Westinghouse Acceptance Bank and of several other acceptance houses, and was chief founder and chairman of the Executive Committee of the American Acceptance Council, a trade association organized in 1919. To write of Warburg's influence is not far-fetched speculation, for he himself boasted of his success in persuading the Federal Reserve to loosen eligibility rules for purchase of acceptances and to establish its policy of buying all acceptances offered at a subsidized rate.[19] Furthermore, Warburg had considerable influence on Benjamin Strong, head of the Federal Reserve Bank of New York, which in these years virtually set the policy of the Federal Reserve.[20]

In these case studies we have seen that inflationism and State control of the monetary system have, in many critical periods of

[19]In his presidential address before the American Acceptance Council, January 19, 1923. See Paul M. Warburg, *The Federal Reserve System* (New York: Macmillan, 1930), vol. 2, p. 822.

[20]Strong assumed his post only at the insistence of Warburg and of Henry Davison of J.P. Morgan and Co., his former employer. See Lester V. Chandler, *Benjamin Strong, Central Banker* (Washington, D.C.: Brookings Institution, 1958), p. 39. Chandler, a eulogizer of Strong, finds that a "major interest of Strong and many of his colleagues, *especially Paul Warburg* [italics mine], during the 1914–17 period was in promoting the creation and use of dollar acceptances—especially bankers' acceptances" (p. 86); see also pp. 91ff. For a critical treatment see Lawrence E. Clark, *Central Banking Under the Federal Reserve System* (New York: Macmillan, 1935), pp. 242–48; 376–78.

American history, been proposed and established, not by "workers and farmers" nor even by disaffected intellectuals, but by groups of merchants, manufacturers, and other businessmen eager to acquire special privilege, to use the State for their own advantage—in short, by men who were essentially modern mercantilists. This mercantilist drive has played a much greater role in the general movement toward statism and central planning than is generally recognized.