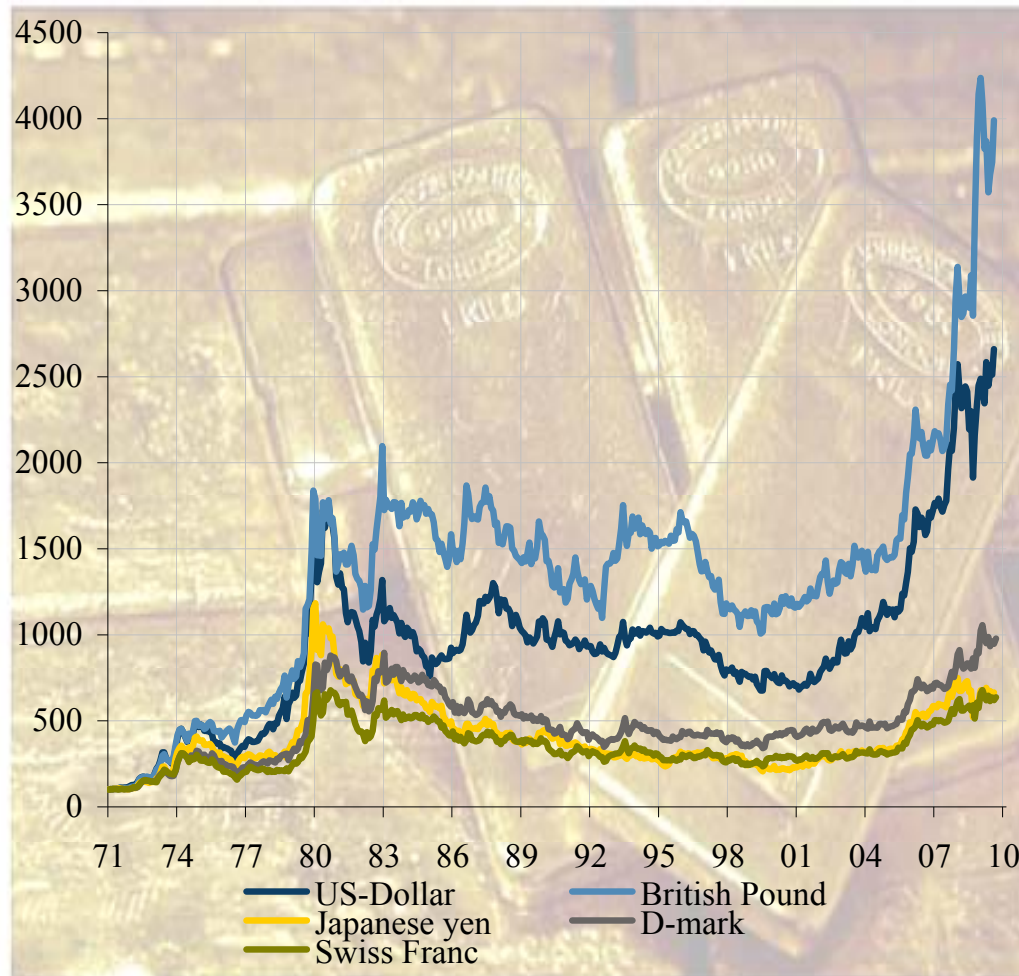

The logic of free market money

6 November 2009

Thorsten Polleit

Fiat monies depreciate against gold

Gold ounce in national currency*



Source : Bloomberg, own calculations.

*Series are indexed: January 1971 = 100.

On money



Carl Menger
1840 – 1921

- Money is the *universally accepted means of exchange*.
- Money has one (and just one) function: *it serves as the medium of exchange*.
 - A rise in the money supply does not confer a social benefit.
- As a good, money is subject to the *law of diminishing marginal utility*.
 - A rise in the money supply is inflation.
- Money originated spontaneously out of *barter* in the free market.
 - Paper money cannot arise out of the free market, it has to be imposed by government.

The *regression theorem*



Ludwig von Mises
1881 – 1973

- Ludwig von Mises (1881 – 1973) showed with his *regression theorem* that money *must* have originated from a good with *intrinsic value*.
 - People hold money because they expect money to have purchasing power (in the future). However, where does this expectation come from?
 - It comes from the experience made in the past, namely that in the past a good served as money.
 - The *regression* can be traced back exactly to the point in time at which a good was used for *non-monetary purposes*.

(Extreme) Rationalism



Immanuel Kant
1724 – 1804

- *Epistemology* – where does our knowledge come from?
→ The debate *rationalism versus empiricism*.
- Kant's message: There is *a priori synthetic knowledge*.
- Mises *reconstructed* economics, making it a *science of the logic of human action* (*praxeology*).
- The centre piece of Mises's praxeology is the *axiom of action*, an a priori truth.
- The axiom of action allows, via *formal logical reasoning*, to establish irrefutable truths.

Government money supply monopolies



Federal Reserve, Washington D.C.



Bank of Japan, Tokyo.



Bank of England, London.



European Central Bank, Frankfurt.

The Austrian Trade Cycle Theory



Ludwig von Mises
1881 – 1973

- The Austrian (or: Misesian) Trade Cycle Theory has a *praxeological foundation*.
- Mises noted: „There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.“

Ludwig von Mises (1996), Human Action, 4th ed. Fox & Wilkes, San Francisco, p. 572.

(Hyper)Inflation



Im Januar 1923 schrieb Ludwig von Mises:

„(...) dass eine Regierung sich immer dann genötigt sieht, zu inflationistischen Maßnahmen zu greifen, wenn sie den Weg der Anleihehebung nicht zu betreten vermag und den der Besteuerung nicht zu betreten wagt, weil sie fürchten muss, die Zustimmung zu dem von ihr befolgten System zu verlieren, wenn sich seine finanziellen und allgemein wirtschaftliche Folgen allzu schnell enthüllen. So wird die Inflation zu dem wichtigsten psychologischen Hilfsmittel einer Wirtschaftspolitik, die ihre Folgen zu verschleiern sucht. Man kann sie in diesem Sinne als ein Werkzeug antidemokratischer Politik bezeichnen, da sie durch Irreführung der öffentlichen Meinung einem Regierungssystem, das bei offener Darlegung der Dinge keine Aussicht auf die Billigung durch das Volk hätte, den Fortbestand ermöglicht.“

Mises, L. v. (1923), S. 32.

On „free banking“ and the gold standard

US\$ per ounce of gold



Source: Bloomberg.

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