Denationalization Of Money

by Thorsten Polleit, a talk held at Freedom Week 2024, Adam Smith Institute and Institute of Economic Affairs, Cambridge University, 23 August 2024.

1.

Let me extend a very warm welcome to all of you, dear ladies and gentlemen, thank you for coming. Thanks very much to the organizers, the Adam Smith Institute and the Institute of Economic Affairs, making possible the Freedom Week 2024 at the University of Cambridge!

Thomas Jefferson (1743–1826) once said: “Freedom is lost gradually from uninterested, uninformed and uninvolved people.”

You guys, however, make sure that people get and remain interested, informed and involved. The importance of your work for our individual freedoms and liberties cannot be overestimated. Thank you very much for your great work!

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The title of my talk is “Denationalization Of Money”. It refers to a book written by the Austrian economist and social philosopher Friedrich August von in 1976.

Hayek was born in 1899 in Vienna, Austria, taught in the United Kingdom and the United States of America, received the Nobel Price of Economics in

1974 (together with Gunnar Myrdal (1898–1987) and died in 1992 in Freiburg, Germany.

Hayek stood in the tradition of the Austrian School of Economics and, as such, had a great interest in monetary theory. Especially in his later works, Hayek became increasingly critical of the idea that the government, the state, should hold the monopoly of money production.

In his "Denationalisation of Money" Hayek noted: „(P)ractically all governments of history have used their exclusive power to issue money in order to defraud and plunder the people."

In a 1984 interview, Hayek was somewhat more explicit, saying that "I don't believe we shall ever have good money again before we take the thing out of the hands of government. If we can't take it violently out of the hands of government, [then] all we can do is by some sly roundabout way introduce something that they can't stop."

(I think it is fair to assume that Hayek might have been delighted had he known about crypto markets!)

In what follows I will (1) outline some fundamental theoretical insights about money, (2) explain the problems that are associated with today's "fiat money" regime, and, against this backdrop, (3) explain Hayek's a case for denationalising, that is allowing for a free market in money.

Before I start, I would like to give you some literature on the topic at hand. To start with, there is Hayek's "Denationalisation of Money", but you may also be interested in the earlier version of the study titled "Currency Choice. A Way To Stop Inflation" from 1975.

I also refer you to the work of Ludwig von Mises (1881–1973) and Murray N. Rothbard (1926–1995) on money and free banking. Also of interest could be my critique of some of Hayek's more technical considerations from 2016. Finally, the book of Larry J. Sechrest (1946–2008) "Free Banking: Theory, History, and a Laissez-Faire Model" from 1993 might also be insightful reading for you.

But now let us start with some fundamentals of money theory.

2.

What is money? The answer is that money is the most widely accepted means of exchange. It is the most liquid, the most marketable good around.

Money is neither a consumer good nor is it a capital good. It is a good *sui generis*; it is the exchange good.

As you probably know, money is said to have three functions: means of exchange, unit of account, and store of value.

However, upon closer inspection, Ludwig von Mises argued in his *Theorie des Geldes und der Umlaufsmittel* (1912) that money has only one

function, namely the means of exchange function. The unit of account and store of value function are merely subfunctions of the means of exchange function.

Indeed, the unit of account function is only an expression of the means of exchange function: it describes the exchange ratio between the monetary units that must be surrendered to obtain the goods in question (say, one hundred US dollars for a shirt).

And the store of value function merely represents a postponement of money's exchange function from the present into the future.

If we agree that money has only one function, the means of exchange function, we come to a rather startling insight, namely that it does not matter how much money is in the economy.

A money supply of, for example, 25 trillion US dollar is as good or as bad as a money supply of, say, 5 trillion US dollar.

If the quantity of money is large, goods prices will be relatively high; if it is small, goods prices will be relatively low. Again, any quantity of money is just as good or bad for financing a given transaction of goods and services as any other.

We can conclude that if money is useful only for exchange, an increase in the quantity of money

will bring no social benefit. It only lowers the purchasing power of the money unit (compared to a situation in which the quantity of money in the economy had remained unchanged).

What about the value of money (or I should say: the purchasing power of money)? As noted earlier, money is a good like any other, it is only special in the sense that it is the most liquid good, and it is only useful for making exchanges.

As a good, its value is determined by the *law of the diminishing marginal utility*. In a nutshell, the law says that the more money units I get, the lower the marginal utility of the money unit becomes relative the value of other vendible items. In other words: The more money unit are available, the lower will be their purchasing power.

Another important insight is that an increase in the quantity of money necessarily leads to a redistribution of income and wealth. The first recipients of the new money benefit at the expense of the late recipients.

The first recipients can spend their new money on goods and services at unchanged prices. As the money moves from hand to hand, so to speak, goods prices rise, so late recipients can buy goods only at elevated prices; this is the so-called “Cantillon effect”.

In other words: An increase in the quantity of money in an economy is never neutral. It creates winners (the early recipients of the new money) and losers (the late recipients of the new money).

3.

If we look back in history, we find that people, whenever they had the freedom to choose their money, preferred precious metals, gold and silver in particular.

The reason is obvious: to serve as money, the good in question must have certain properties: It must be scarce, durable, highly divisible, portable, storable, and have a high value per unit of weight, to name just a few qualities.

Because gold and silver are supremely “money-like” commodities, they were chosen by the free supply and demand in the market as money when they were available.

Now you might ask: Why are we no longer using gold and silver as money? Let me try to provide a short answer.

By the last quarter of the nineteenth century, most countries had eventually adopted gold as a means of payment. This meant, at least in theory, that people, in their daily transactions, used gold coins as well as banknotes and bank deposit

money, which were all redeemable into physical gold at the issuing banks.

At the beginning of World War I, however, many countries ended the gold redeemability of their currencies. Why? Well, governments wanted to finance their wartime expenditures by means of the “inflation tax,” that is, by issuing unbacked paper money. And so, they severed the link between physical gold and the currencies they printed.

The result was high inflation, in some countries, even hyperinflation (like, say, in Germany, Austria, and Hungary).

After the war ended in 1918, most nations failed to return to gold money. Great Britain went off the gold standard in 1931. The big exception was the United States. Even in World War I, the US dollar had kept its gold backing.

In 1944, forty-four nations signed the Bretton Woods Agreement, which took effect after the end of World War II in 1945. The Bretton Woods system made the US dollar the world’s reserve currency, replacing the British pound. Thirty-five US dollars were equivalent to one ounce of gold (that is 31,10 … grams).

By the way: The Bretton Woods system was not a gold standard; it was something like a pseudo- or fake gold standard. But it worked, at least

initially. The reason it eventually collapsed was that the Americans didn’t play by the rules.

They kept issuing more and more US dollars that were not backed by physical gold. People worldwide lost faith in the promise that the US could redeem the greenback for the yellow metal.

As more and more nations rushed to exchange their US dollars for gold at the New York Fed, the US gold stock dwindled, and the US run the risk of defaulting on its gold payment obligations.

On August 15, 1971, US president Richard Nixon took decisive action. He announced that the US dollar would no longer be redeemable for gold.

This unilateral decision by Nixon brought the world an unbacked paper money, or fiat money, system.

Nixon’s decision actually amounted to the greatest act of monetary expropriation in modern history. And it brought us the fiat money problem that still haunts us today.

The US economist Milton Friedman (1912–2006) put it quite diplomatically: “A world monetary system has emerged that has no historical precedent: a system in which every major currency in the world is … on an irredeemable paper money standard … . The ultimate

consequences of this development are shrouded in uncertainty.”

4.

As Friedman insinuated, today’s worldwide paper or “fiat” money regime is indeed economically and socially highly problematic—with negative consequences that extend beyond what most people would imagine.

Fiat money can be characterized by three factors. (1) It is money monopolized by the state and its central bank. (2) Fiat money is created through bank lending, it is created out of thin air. (3) Fiat money is dematerialized money in the form of colorful paper tickets and bits and bytes on computer hard drives.

Fiat money is inflationary—it loses its purchasing power over time.

Fiat money benefits a few at the expense of many others—so we can say that fiat money is socially unjust.

Fiat money causes boom-and-bust cycles—it sets in motion an artificial economic upswing followed by a crash.

Fiat money leads to overindebtedness—it is created through bank credit expansion, and the economies’ debt burden outpaces income growth.

Fiat money allows the state to become ever bigger and more powerful—at the expense of civil liberties and freedom. It also helps financing war at relatively low political costs.

5.

It is in this context that, I think, that the issue of Central Bank Digital Currency (CBDC) must be addressed.

The need for a centralized digital means of payment is one of the main official arguments for why central banks should issue digital central bank currency. However, the truth might be somewhat different.

By issuing CBDC, central banks want, first and foremost, to uphold their fiat money monopoly: They do not want private money (be it, say, bitcoin or Ethereum) to out-compete official fiat currencies.

This is problematic given that there are quite a few issues with central bank digital currencies (which, I think, tend to be neglected or overlooked in the current debate).

First, central bank digital currencies are not "better monies." They represent fiat monies. As such, fiat central bank digital currencies suffer from the same economic and ethical defects as analogue and electronic fiat monies.

Second, central bank digital currencies will most likely replace cash or allow governments to phase out coins and notes. And so, people will most likely lose their only means of making anonymous payments, and what little is left of their financial privacy will be gone.

Third, without cash you no longer can withdraw your money from the banking system. It can be expropriated through negative interest rates imposed by the central bank.

Fourth, as central bank digital currencies become increasingly accepted, they can easily be instrumentalized for further political purposes. Just think of China's social credit system.

Imagine, if you will, only getting access to central bank digital currency if you comply with the government's directives (or comply with the wishes of those special interest groups that determine the government's orders).

If you don't, you suffer disadvantages: you will no longer be able to travel, order certain newspapers and books or buy groceries; your accounts may be frozen, and your money even confiscated if you dare dissent too much with the government's directives.

The list of such antifreedom atrocities that become a possibility in a world of central bank digital currencies goes on and on – and it should

make us at least hesitant to lend support to the idea of central banks issuing CBDC.

6.

Against the backdrop of the existing fiat money regime and its problems the question arises: Why not end the fiat money regime and replace it with a better system?

This is what Friedrich August von Hayek proposed in his “Denationalisation of Money”, published in 1976: to put an end to the state’s (or government’s) monopoly of money production, that is “denationalising money”, replacing it by a free market in money.

Now you may ask: How would a ‘free market in money’ work?

I guess most of you like free choice – when buying, say, food, sport shoes, books, computers, furniture, cars, houses, etc. And I guess it doesn’t take much to convince you that a free market caters best to the needs of the consumers, providing them with goods of the highest quality at the lowest possible prices.

But when it comes to money, people may be asking themselves: How could a free market in money possibly work? Well, it would work like any free market:

People, making exchanges, would preferably use that type of medium that is most widely accepted, that has the highest marketability.

I, for instance, would seek to get hold of a medium which is, from the viewpoint of my trading partner (say, a baker), most highly valued. And my baker, in turn, would seek to hold a medium that can most easily be exchanged at, say, the shoemaker. And so on.

In other words, in a free market in money it would be the *demand for money* that determines what money is. It is the people in the free marketplace that make this choice.

What kind of medium would be chosen as money? People will demand good or sound money, and sound money has certain characteristics:

For instance, it is scarce, homogeneous, durable, divisible, mintable, transportable, it must represent a relatively high exchange value per unit, etc.

When we look into monetary history, we see that people mostly, if they had the freedom to do so, opted for precious metals as money, preferably gold and silver, even copper to a degree – because precious metals were, from the viewpoint of money users, considered the best option.

Of course, we wouldn't know what kind of money would emerge if we open up a free market in

money. As you know, the free market is a *discovery process*, as Hayek put it, and its outcome cannot be predicted with certainty.

However, in view of what we have just said, it is highly likely that people would, if we open up a free market in money, opt for gold and silver as money, perhaps for a crypto unit such as bitcoin.

Wouldn't result a free market money in chaos, as hundreds even thousand or million monies would compete with each other? The answer is no.

The reason is that the optimal number of monies in the economy is one. If all people use the same money, money's productive benefit is maximised. That said, free market in money would sooner or later come up with a single money proper.

What is more, it is important to distinguish between money proper and money substitutes.

As noted earlier, in a free market in money, people with free choice would decide what good(s) will become money proper (such as, for instance, gold or silver or a crypto unit).

Then, people will most likely demand services of money warehouses, or banks for that matter. Money warehouses would spring up, offering services in terms of storage, settlement and safeguarding money proper.

If, for instance, Mr. Smith decides to deposit 10 gold ounces with a money warehouse (say, the Polleit Money Warehouse), he will receive in return a money warehouse receipt (a money substitute). That said, money warehouses will compete in terms of money substitutes, not in money proper.

To sum up: In a truly free market in money, people freely choose the kind of money they wish to use, and once this has been decided, the remaining competition is among money substitutes issued by competing money warehouses.

7.

From an economic point of view, the current state of monetary affairs in this world is rather unsatisfactory, to put it mildly.

Our fiat monies are inflationary, socially unjust, they cause crises and lead to over-indebtedness, and they allow the states to become bigger and more powerful – at the expense of civil and entrepreneurial freedoms and liberties. And don't we forget: Fiat money is the money of war.

It is against this backdrop that there are important lessons that can be learned from Hayek's "Denationalisation Of Money".

No. 1: Hayek reminds us that that there is no compelling economic or ethical reason why the state should hold the money monopoly; in fact, that

providing the state (and thus the special interest groups that use the state's coercive power for their purposes) with the authority over money will lead to inflation and its accompanying economic and societal evils.

No. 2: Hayek rightfully points out that a free market for money is possible – and that it is, no doubt about that, economically and ethically superior to today's states' controlled money monopoly regimes.

No. 3: Hayek brings to our attention what Carl Menger (1840–1921), the 'founding father' of the Austrian School, had pointed out already in his book "Principles of Economics" in 1871: namely that money is a free market phenomenon, that it emerged spontaneously from the free market, and out of a commodity (such as, say, gold and silver; in fact, it is an insight that should make us understand better the developments in the markets for crypto units).

According to Menger, money did not, and Ludwig von Mises explained this in 1912 with his *regression theorem,* through state action. It did not, and does not, require a state (as we know it today) for money coming into existence. We have good reason to expect that a free market in money will work just fine.

No. 4: A free market in money can be set into motion by a) ending the ‘legal tender status’ of official currencies, b) ending capital gain taxes and VAT on potential money candidates such as gold, silver and crypto units, and c) ending all remaining regulations that stands in the way of using other means for payments than official currencies.

A free market in money will end chronic inflation, money-driven boom & bust and their economic and financial crises; it will prevent states from spinning out of control, it will preserve and restore, individual liberties and freedoms, enhance the wealth of the nations, make the world more peaceful.

I hope my remarks have been encouraging and inspiring for you, increase your in Hayek’s idea of “denationalising money”, in creating a free market in money.

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