Week 3: Feb. 15 – 21   Money and Its Enemies

CHAPTER 5:   Money as an Economic Good

1 Money Neither a Production Good nor a Consumption Good

It is usual to divide economic goods into the two classes of those which satisfy human needs directly and those which only satisfy them indirectly: that is, **consumption goods, or goods of the first order; and production goods, or goods of higher orders**. [1] The attempt to include money in either of these groups meets with *insuperable* difficulties. It is unnecessary to demonstrate that money is not a consumption good. It seems equally incorrect to call it a production good.

Of course, if we regard the twofold division of economic goods as exhaustive we shall have to rest content with putting money in one group or the other. This has been the position of most economists; and since it has seemed altogether impossible to call money a consumption good, there has been no alternative but to call it a production good.

This apparently arbitrary procedure has usually been given only a very cursory vindication. Roscher, for example, thought it sufficient to mention that money is "the chief instrument of every transfer" (*vornehmstes Werkzeug jeden Verkehrs*). [2]

In opposition to Roscher, Knies made room for money in the classification of goods by replacing the twofold division into production goods and consumption goods by a threefold division into means of production, objects of consumption, and media of exchange. [3] His arguments on this point, which are unfortunately scanty, have hardly attracted any serious attention and have been often misunderstood. Thus Helfferich attempts to confute Knies's proposition, that a sale-and-purchase transaction is not in itself an act of production but an act of (interpersonal) transfer, by asserting that the same sort of objection might be made to the inclusion of means of transport among instruments of production on the grounds that transport is not in itself an act of production but an act of (interlocal) transfer and that the nature of goods is no more altered by transport than by a change of ownership. [4]

Obviously, it is the ambiguity of the German word*Verkehr* that has obscured the deeper issues here involved. On the one hand,*Verkehr* bears a meaning that may be roughly translated by the word *commerce*; that is, the exchange of goods and services on the part of individuals. But it also means the transfer through space of persons, goods, and information. These two groups of things denoted by the German word *Verkehr* have nothing in common but their name. It is therefore impossible to countenance the suggestion of a relationship between the two meanings of the word that is involved in the practice of speaking of "*Verkehr* in the broader sense," by which is meant the transfer of goods from one person's possession to that of another, and "*Verkehr*in the narrower sense," by which is meant the transfer of goods from one point in space to another. [5] Even popular usage recognizes two distinct meanings here, not a narrower and a broader version of the same meaning.

The common nomenclature of the two meanings, as also their incidental confusion, may well be attributable to the fact that exchange transactions often, but by no means always, go hand in hand with acts of transport, through space and vice versa. [6]But obviously this is no reason why science should impute an intrinsic similarity to these essentially different processes.

It should never have been called in question that the transportation of persons, goods, and information is to be reckoned part of production, so far as it does not constitute an act of consumption, as do pleasure trips for example. All the same, two things have hindered recognition of this fact. The first is the widespread misconception of the nature of production. There is a naive view of production that regards it as the bringing into being of matter that did not previously exist, as creation in the true sense of the word. From this it is easy to derive a contrast between the creative work of production and the mere transportation of goods. This way of regarding the matter is entirely inadequate. In fact, the role played by man in production always consists solely in combining his personal forces with the forces of Nature in such a way that the cooperation leads to some particular desired arrangement of material. No human act of production amounts to more than altering the position of things in space and leaving the rest to Nature. [7] This disposes of one of the objections to regarding transportation as a productive process.

The second objection arises from **insufficient insight into the nature of goods.** It is often overlooked that, among other natural qualities, the position of a thing in space has important bearings on its capacity for satisfying human wants. Things that are of perfectly identical technological composition must yet be regarded as specimens of different kinds of goods if they are not in the same place and in the same state of readiness for consumption or further production. Till now the position of a good in space has been recognized only as a factor determining its economic or noneconomic nature. It is hardly possible to ignore the fact that drinking water in the desert and drinking water in a well-watered mountain district, despite their chemical and physical similarity and their equal thirst-quenching properties, have nevertheless a totally different significance for the satisfaction of human wants. The only water that can quench the thirst of the traveler in the desert is the water that is on the spot, ready for consumption.

Within the group of economic goods itself, however, the factor of situation has been taken into consideration only for goods of certain kinds—those whose position has been fixed, whether by man or nature; and even among these, attention has seldom been given to any but the most outstanding example, land. As far as movable goods are concerned, the factor of situation has been treated as negligible.

This attitude is in consonance with commercial technology. The microscope fails to reveal any difference between two lots of beet sugar, of which one is warehoused in Prague and the other in London. But for the **purposes of economics it is better to regard the two lots of sugar as goods of different kinds.** Strictly speaking, **only those goods should be called goods of the first order which are already where they can immediately be consumed**. All other economic goods, even if they are ready for consumption in the technological sense, must be regarded as goods of higher orders which can be transmuted into goods of the first order only by combination with the complementary good, "means of transport." Regarded in this light, means of transport are obviously production goods. "Production," says Wieser, "is the utilization of the more advantageous among remote conditions of welfare." [8]There is nothing to prevent us from interpreting the word *remote* in its literal sense for once, and not just figuratively.

We have seen that transfer through space is one sort of production; and means of transport, therefore, so far as they are not consumption goods such as pleasure yachts and the like, must be included among production goods. Is this true of money as well? Are the economic services that money renders comparable with those rendered by means of transport? Not in the least. Production is quite possible without money. There is no need for money either in the isolated household or in the socialized community. Nowhere can we discover a good of the first order of which we could say that the use of money was a necessary condition of its production.

It is true that the majority of economists reckon money among production goods. Nevertheless, arguments from authority are invalid; the proof of a theory is in its reasoning, not in its sponsorship; and with all due respect for the masters, it must be said that they have not justified their position very thoroughly in this matter. This is most remarkable in Böhm-Bawerk. As has been said, Knies recommends the substitution of a threefold classification of economic goods into objects of consumption, means of production, and media of exchange, for the customary twofold division into consumption goods and production goods. In general, Böhm-Bawerk treats Knies with the greatest respect and, whenever he feels obliged to differ from him, criticizes his arguments most carefully. But in the present case he simply disregards them. He unhesitatingly includes money in his concept of social capital, and incidentally specifies it as a product destined to assist further production. He refers briefly to the objection that money is an instrument, not of production, but of exchange; but instead of answering this objection, he embarks on an extended criticism of those doctrines that treat stocks of good in the hands of producers and middlemen as goods ready for consumption instead of as intermediate products.

Böhm-Bawerk's argument proves conclusively that production is not completed until the goods have been brought to the place where they are wanted, and that it is illegitimate to speak of goods being ready for consumption until the final process of transport is completed. But it contributes nothing to our present discussion; for the chain of reasoning gives way just at the critical link. After having proved that the horse and wagon with which the farmer brings home his corn and wood must be reckoned as means of production and as capital, Böhm-Bawerk adds that "logically all the objects and apparatus of 'bringing home' in the broader economic sense, the things that have to be transported, the roads, railways, and ships, and the commercial tool *money*, must be included in the concept of capital." [9]

This is the same jump that Roscher makes. It leaves out of consideration the difference between transport, which consists in an alteration of the utility of things, and exchange, which constitutes a separate economic category altogether. It is illegitimate to compare the part played by money in production with that played by ships and railways. Money is obviously not a "commercial tool" in the same sense as account books, exchange lists, the stock exchange, or the credit system.

Böhm-Bawerk's argument in its turn has not remained uncontradicted. Jacoby objects that while it treats money and the stocks of commodities in the hands of producers and middlemen as social capital, it nevertheless maintains the view that social capital is a pure economic category and independent of all legal definitions, although money and the "commodity" aspect of consumption goods are peculiar to a "commercial" type of economic organization. [10]

The invalidity of this criticism, so far as it is an objection to regarding commodities as production goods, is implied by what has been said above. There is no doubt that Böhm-Bawerk is in the right here, and not his critic. It is otherwise with the second point, the question of the inclusion of money. Admittedly, Jacoby's own discussion of the capital concept is not beyond criticism, and Böhm-Bawerk's refusal to accept it is probably justified. [11] But that does not concern us at present. We are only concerned with the problem of the concept of goods. On this point as well Böhm-Bawerk disagrees with Jacoby. In the third edition of volume two of his masterpiece, Capital and Interest, he argues that even a complex socialistic organization could hardly do without undifferentiated orders or certificates of some sort, "like money," which refer to the product awaiting distribution. [12]This particular argument of his was not directly aimed at our present problem. Nevertheless, it is desirable to inquire whether the opinion expressed in it does not contain something that may be useful for our purpose as well.

Every sort of economic organization needs not only a mechanism for production but also a mechanism for distributing what is produced. It will scarcely be questioned that the distribution of goods among individual consumers constitutes a part of production, and that in consequence we should include among the means of production not only the physical instruments of commerce such as stock exchanges, account books, documents, and the like, but also everything that serves to maintain the legal system which is the foundation of commerce, as, for example, fences, railings, walls, locks, safes, the paraphernalia of the law courts, and the equipment of the organs of government entrusted with the protection of property. In a socialist state, this category might include among other things Böhm-Bawerk's "undifferentiated certificates" (to which, however, we cannot allow the description "like money"; for since money is not a certificate, it will not do to say of a certificate that it is like money. Money is always an economic good, and to say of a claim, which is what a certificate is, that it is like money, is only to drop back into the old practice of regarding rights and business connections as goods. Here we can invoke Böhm-Bawerk's own authority against himself). [13]

What prevents us nevertheless from reckoning money among these "distribution goods" and so among production goods (and incidentally the same objection applies to its inclusion among consumption goods) is the following consideration. The loss of a consumption good or production good results in a loss of human satisfaction; it makes mankind poorer The gain of such a good results in an improvement of the human economic position; it makes mankind richer The same cannot be said of the loss or gain of money. Both changes in the available quantity of production goods or consumption goods and changes in the available quantity of money involve changes in values; but whereas the changes in the value of the production goods and consumption goods do not mitigate the loss or reduce the gain of satisfaction resulting from the changes in their quantity, the changes in the value of money are accommodated in such a way to the demand for it that, despite increases or decreases in its quantity, the economic position of mankind remains the same. An increase in the quantity of money can no more increase the welfare of the members of a community, than a diminution of it can decrease their welfare. Regarded from this point of view, those goods that are employed as money are indeed what Adam Smith called them, "dead stock, which ... produces nothing." [14]

We have shown that, under certain conditions, indirect exchange is a necessary phenomenon of the market. The circumstance that goods are desired and acquired in exchange not for their own sakes but only in order to be disposed of in further exchange can never disappear from our type of market dealing, because the conditions that make it inevitable are present in the overwhelming majority of all exchange transactions. Now the economic development of indirect exchange leads to the employment of a common medium of exchange, to the establishment and elaboration of the institution of money. Money, in fact, is indispensable in our economic order But as an economic good it is not a physical component of the social distributive apparatus in the way that account books, prisons, or firearms are. No part of the total result of production is dependent on the collaboration of money, even though the use of money may be one of the fundamental principles on which the economic order is based.

Production goods derive their value from that of their products. Not so money; for no increase in the welfare of the members of a society can result from the availability of an additional quantity of money. The laws which govern the value of money are different from those which govern the value of production goods and from those which govern the value of consumption goods. All that these have in common is their general underlying principle, the fundamental economic law of value. This is a complete justification of the suggestion put forward by Knies that economic goods should be divided into means of production, objects of consumption, and media of exchange; for, after all, the primary object of economic terminology is to facilitate investigation into the theory of value.

2 Money as Part of Private Capital

We have not undertaken this investigation into the relationship between money and production goods merely for its terminological interest. What is of importance for its own sake is not our ultimate conclusion, but the incidental light shed by our argument upon those peculiarities of money that distinguish it from other economic goods. These special characteristics of the common medium of exchange will receive closer attention when we turn to consider the laws that regulate the value of money and its variations.

But the result of our reasoning, too, the conclusion that money is not a production good, is not entirely without significance. It will help us to answer the question whether money is capital or not. This question in its turn is not an end in itself, but it provides a check upon the answer to a further problem concerning the relations between the equilibrium rate of interest and the money rate of interest, which will be dealt with in the third part of this book. If each conclusion confirms the other, then we may assume with a considerable degree of assurance that our arguments have not led us into error.

The first grave difficulty in the way of any investigation into the relation between money and capital arises from the difference of opinion that exists about the definition of the concept of capital. The views of scholars on the definition of capital are more divergent than their views on any other point of economics. None of the many definitions that have been suggested has secured general recognition; nowadays, in fact, the controversy about the theory of capital rages more fiercely than ever. If from among the large number of conflicting concepts we select that of Böhm-Bawerk to guide us in our investigation into the relation of money to capital, we could justify our procedure merely by reference to the fact that Böhm-Bawerk is the best guide for any serious attempt to study the problem of interest, even if such a study leads eventually (and by no means entirely without indebtedness to the labor that Böhm-Bawerk bestowed on this problem) to conclusions that differ widely from those which he himself arrived at. Furthermore, all those weighty arguments with which Böhm-Bawerk established his concept and defended it against his critics support such a choice. But quite apart from these, a reason that appears to be quite decisive is provided by the fact that no other concept of capital has been developed with equal clarity. [15] This last point is particularly important. It is not the object of the present discussion to arrive at any kind of conclusion respecting terminology or to provide any criticism of concepts, but merely to shed some light on one or two points that are of importance for the problem of the relations between the equilibrium and the money rates of interest. Hence it is less important for us to classify things correctly than to avoid vague ideas about their nature. Various opinions may be held as to whether money should be included in the concept of capital or not. The delimitation of concepts of this nature is merely a question of expediency, in connection with which it is quite easy for differences of opinion to arise. But the economic function of money is a matter about which it should be possible to arrive at perfect agreement.

Of the two concepts of capital that Böhm-Bawerk distinguishes, following the traditional economic terminology, that of what is called private or acquisitive capital is both the older and the wider. This was the original root idea from which the narrower concept of social or productive capital was afterward separated. It is therefore logical to begin our investigation by inquiring into the connection between private capital and money.

Böhm-Bawerk defines private capital as the aggregate of the products that serve as a means to the acquisition of goods. [16] It has never been questioned that money must be included in this category. In fact, the development of the scientific concept of capital starts from the notion of an interest-bearing sum of money. This concept of capital has been broadened little by little until at last it has taken the form which it bears in modern scientific discussion, on the whole in approximate coincidence with popular usage.

The gradual evolution of the concept of capital has meant at the same time an increasing understanding of the function of money as capital. Early in history the lay mind discovered an explanation of the fact that money on loan bears interest—that money, in fact, "works." But such an explanation as this could not long satisfy scientific requirements. Science therefore countered it with the fact that money itself is barren. Even in ancient times general recognition must have been accorded to the view which later in the shape of the maxim *pecunia pecuniam parere non potest* was to be the basis of all discussion of the problem of interest for hundreds and even thousands of years, and Aristotle undoubtedly did not state it in the famous passage in his *Politics* as a new doctrine but as a generally accepted commonplace. [17] Despite its obviousness, this perception of the physical unfruitfulness of money was a necessary step on the way to full realization of the problem of capital and interest. If sums of money on loan do bear "fruit," and it is not possible to explain this phenomenon by the physical productivity of the money, then other explanations must be sought.

The next step toward an explanation was provided by the observation that after a loan is made the borrower as a rule exchanges the money for other economic goods, and that those owners of money who wish to obtain a profit from their money without lending it do the same. This was the starting point for the extension of the concept of capital referred to above, and for the development of the problem of the money rate of interest into the problem of the "natural" rate of interest.

It is true that centuries passed before these further steps were accomplished. At first there was a complete halt in the development of the theory of capital. Further progress was in fact not desired; what was already attained sufficed perfectly; for the aim of science then was not to explain reality but to vindicate ideals. And public opinion disapproved of the taking of interest. Even later, when the taking of interest was recognized in Greek and Roman law, it was still not considered respectable, and all the writers of classical times strove to outdo one another in condemning it. When the church adopted this proscription of interest, and attempted to support its attitude by quotations from the Bible, it cut the ground away from beneath all unauthorized attempts to deal with the matter. Every theorist who turned his attention to the problem was already convinced that the taking of interest was harmful, unnatural, and uncharitable, and found his principal task in the search for new objections to it. It was not for him to explain how interest came to exist, but to sustain the thesis that it was reprehensible. In such circumstances it was easy for the doctrine of the sterility of money to be taken over uncritically by one writer from another as an extraordinarily powerful argument against the payment of interest, and thus, not for the sake of its content but for the sake of the conclusion it supported, to become an obstacle in the way of the development of interest theory. It became a help and no longer a hindrance to this development, when a move was made toward the construction of a new theory of capital after the downfall of the old canonist theory of interest. Its first effect, then, was to necessitate an extension of the concept of capital, and consequently of the problem of interest. In popular usage and in the terminology of scholars, capital was no longer "sums of money on loan" but "accumulated stocks of goods." [18]

The doctrine of the unfruitfulness of money has another significance for our problem. It sheds light on the position of money within the class of things constituting private capital. Why do we include money in capital? Why is interest paid for sums of money on loan? How is it possible to use sums of money, even without lending them, so that they yield an income? There can be no doubt about the answers to these questions. Money is an acquisitive instrument only when it is exchanged for some other economic good. In this respect money may be compared with those consumption goods that form part of private capital only because they are not consumed by their owners themselves but are used for the acquisition of other goods or services by means of exchange. Money is no more acquisitive capital than these consumption goods are; the real acquisitive capital consists in the goods for which the money or the consumption goods are exchanged. Money that is lying "idle," that is, money that is not exchanged for other goods, is not a part of capital; it produces no fruit. Money is part of the private capital of an individual only if and so far as it constitutes a means by which the individual in question can obtain other capital goods.

3 Money Not a Part of Social Capital

By social or productive capital Böhm-Bawerk means the aggregate of the products intended for employment in further production. [19] If we accept the views expounded above, according to which money cannot be included among productive goods, then neither can it be included in social capital. It is true that Böhm-Bawerk includes it in social capital, as the majority of the economists that preceded him had done. This attitude follows logically from regarding money as a productive good; this is its only justification, and in endeavoring to show that money is not a productive good we have implied how baseless a justification it is.

In any case, perhaps we may suggest that those writers who include money among productive goods and consequently among capital goods are not very consistent. They usually reckon money as a part of social capital in that division of their systems where they deal with the concepts of money and capital, but certain obvious further conclusions are not drawn from this. On the contrary, where the doctrine of the nature of money as capital should logically be applied it appears to have been suddenly forgotten. In reviewing the determinants of the rate of interest, writers emphasize over and over again that it is not the greater or smaller quantity of money that is of importance, but the greater or smaller quantity of other economic goods. To reconcile this assertion, which is indubitably a correct summary of the matter, with the other assertion that money is a productive good, is simply impossible.

Chapter 5: MONEY AS AN ECONOMIC GOOD (Study Guide)

1. Money Neither a Production Good nor a Consumption Good

Traditionally, economic goods were divided into consumption goods (what Menger called goods of the first order) and production goods (what Menger called goods of higher orders). Consumption goods directly satisfied human desires, whereas production goods only satisfied them indirectly. (For example, an apple might be a consumption good to a hungry man, while an apple seed would be a production good.) If we insist on a two-fold scheme, then money must be a production good, since it is clearly not a consumption good. Yet this is problematic too, because money is very different from other types of production goods.

A solution is to adopt a three-fold system, consisting of consumption goods, production goods, and media of exchange. This makes sense, because money is not a "commercial tool" in the same way that account books are. Although in a certain sense money "facilitates commerce" just as boats and railroads do, they differ in a crucial way: Increasing the supply of money does not make the community richer, whereas having more boats, railroads, and other production goods allows for the greater satisfaction of human desires. This is why money should be classified in a separate category, namely media of exchange.

2. Money as Part of Private Capital

Private capital can be defined as the aggregate of the products that serve as a means to the acquisition of goods. Money should clearly be included in this category, and in fact historically an interest bearing sum of money was the starting point of the concept of "capital."

Over time, theorists realized that money was "barren" and did not directly yield its "fruits" the way physical seeds or human labor could. To explain why people would be willing to pay interest on money loans, we must recognize that money can be *exchanged* for other, productive goods. This observation reinforces the decision to classify money as a medium of exchange, rather than a production good: the only way to salvage the inclusion of money as a part of private capital, is to *distinguish* it from other production goods and recognize its special ability to be exchanged for them.

3. Money Not a Part of Social Capital

Social (or productive) capital can be defined as the aggregate of the products intended for employment in further production. If we deny that money is a production good, then obviously it cannot be a part of social (or productive) capital.

- Mises's summaries of various debates (on whether money is a production good, or whether it is part of social capital) may strike some readers as difficult or even tedious. However, in these passages Mises demonstrates his command of the literature, but also he explains *why* he favors one view over another. At times Mises differs from Eugen von Böhm-Bawerk, the great pioneer in (what we now call) Austrian economics after Menger. The reader can see that Mises is not simply following in the path laid out by his predecessors in the Austrian tradition, but instead weighs the arguments by various thinkers, and builds the Misesian system with the strongest components of each.

- As with his classification of money substitutes, credit money, etc., in this chapter Mises exercises great precision in defining his concepts and justifying his decisions. For the issues in this chapter, Mises tells the reader (p. 86) that the groundwork will be important for understanding the discussion of the **equilibrium and money rates of interest**, which will occur in part III of the book.

Equilibrium rate of interest: The rate of interest corresponding to the true supplies of capital goods and consumer preferences for present versus future consumption. Also known as the natural rate of interest.

Money rate of interest: The rate of interest determined in the marketplace for loans of money. (The money rate can deviate from the equilibrium [or natural] rate of interest, in a process that is explained in part III of the book.)

Private capital: The aggregate of the products that serve as a means to the acquisition of goods.
Social (productive) capital: The aggregate of the products intended for employment in further production.
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What are the views of Roscher and Knies with respect to classifying money? (p. 79)

What was Helfferich's objection to those (like Knies) who wanted to deny that a monetary exchange was an act of production? (pp. 79 –80)

Explain: “Money is obviously not a ‘commercial tool’ in the same sense as account books, exchange lists, the Stock Exchange, or the credit system.” (p. 83)

Explain: “[W]hereas the changes in the value of . . . production goods and consumption goods do not mitigate the loss or reduce the gain of satisfaction resulting from . . . changes in their quantity, . . . changes in the value of money are accommodated in such a way to the demand for it that, despites increase or decreases in its quantity, the economic position of mankind remains the same.” (p. 85)

What hindered the development of a scientific understanding of capital and interest? (pp. 88 –89)

CHAPTER 6: The Enemies of Money

1. Money in the Socialist Community

It has been shown that under certain conditions, which occur the more frequently as division of labor and the differentiation of wants are extended, indirect exchange becomes inevitable; and that the evolution of indirect exchange gradually leads to the employment of a few particular commodities, or even one commodity only, as a common medium of exchange. When there is no exchange of any sort, and hence no indirect exchange, the use of media of exchange naturally remains unknown. This was the situation when the isolated household was the typical economic unit, and this, according to socialist aspirations, is what it will be again one day in that purely socialistic order where production and distribution are to be systematically regulated by a central body. This vision of the future socialistic system has not been described in detail by its prophets; and, in fact, it is not the same vision which they all see. There are some among them who allow a certain scope for exchange of economic goods and services, and so far as this is the case the continued use of money remains possible.

On the other hand, the certificates or orders that the organized society would distribute to its members cannot be regarded as money. Supposing that a receipt was given, say, to each laborer for each hour's labor, and that the social income, so far as it was not employed for the satisfaction of collective needs or the support of those not able to work, was distributed in proportion to the number of receipts in the possession of each individual, so that each receipt represented a claim to an aliquot part of the total amount of goods to be distributed. Then the significance of any particular receipt as a means of satisfying the wants of an individual, in other words its value, would vary in proportion to the size of the total dividend. If, with the same number of hours of labor, the income of the society in a given year was only half as big as in the previous year, then the value of each receipt would likewise be halved.

The case of money is different. A decrease of fifty percent in the real social income would certainly involve a reduction in the purchasing power of money. But this reduction in the value of money need not bear any direct relation to the decrease in the size of the income. It might accidentally happen that the purchasing power of money was exactly halved also; but it need not happen so. This difference is of fundamental importance.

In fact, the exchange value of money is determined in a totally different way from that of a certificate or warrant. Titles like these are not susceptible of an independent process of valuation at all. If it is certain that a warrant or order will always be honored on demand, then its value will be equal to that of the goods to which it refers. If this certainty is not absolute, the value of the warrant will be correspondingly less.

If we suppose that a system of exchange might be developed even in a socialist society—not merely the exchange of labor certificates but, say, the exchange of consumption goods between individuals—then we may conceive of a place for the function of money even within the framework of such a society. This money would not be so frequently and variously employed as in an economic order based on private ownership of the means of production, but its use would be governed by the same fundamental principles.

These considerations dictate the attitude toward money that must be assumed by any attempt to construct **an imaginary** social order, if self-contradiction is to be avoided. So long as such a scheme completely excludes the free exchange of goods and services, then it follows logically that it has no need for money; but so far as any sort of exchange at all is allowed, it seems that indirect exchange achieved by means of a common medium of exchange must be permitted also.

2 Money Cranks

Superficial critics of the capitalistic economic system are in the habit of directing their attacks principally against money. They are willing to permit the continuance of private ownership of the means of production and consequently, given the present stage of division of labor, of free exchange of goods also; and yet they want this exchange to be achieved without any medium, or at least without a *common* medium, or money. They obviously regard the use of money as harmful and hope to overcome all social evils by eliminating it. Their doctrine is derived from notions that have always been extraordinarily popular in lay circles during periods in which the use of money has been increasing.

All the processes of our economic life appear in a monetary guise; and those who do not see beneath the surface of things are only aware of monetary phenomena and remain unconscious of deeper relationships. Money is regarded as the cause of theft and murder, of deception and betrayal. Money is blamed when the prostitute sells her body and when the bribed judge perverts the law. It is money against which the moralist declaims when he wishes to oppose excessive materialism. Significantly enough avarice is called the love of money; and all evil is attributed to it. [1]

The confused and vague nature of such notions as these is obvious. It is not so clear whether it is thought that a return to direct exchange by itself will be able to overcome all the disadvantages of the use of money, or whether it is thought that other reforms will be necessary as well. The world makers and world improvers responsible for these notions feel no obligation to follow up their ideas inexorably to their final consequences. They prefer to call a halt at the point where the difficulties of the problem are just beginning. And this, incidentally, accounts for the longevity of their doctrines; so long as they remain nebulous, they offer nothing for criticism to seize upon.

Even less worthy of serious attention are those schemes of social reform which, while not condemning the use of money in general, object to the use of gold and silver In fact, such hostility to the precious metals has something very childish in it. When Thomas More, for example, endows the criminals in his utopia with golden chains and the ordinary citizens with gold and silver chamber pots, [2] it is in something of the spirit that leads primitive mankind to wreak vengeance on lifeless images and symbols.

It is hardly worthwhile to devote even a moment to such fantastic suggestions, which have never been taken seriously. All the criticism of them that was necessary has been completed long ago. [3] But one point, which usually escapes notice, must be emphasized.

Among the many confused enemies of money there is one group that fights with other theoretical weapons than those used by its usual associates. These enemies of money take their arguments from the prevailing theory of banking and propose to cure all human ills by means of an "elastic credit system, automatically adapted to the need for currency." It will surprise no one acquainted with the unsatisfactory state of banking theory to find that scientific criticism has not dealt with such proposals as it should have done, and that it has in fact been incapable of doing so. The rejection of schemes such as Ernest Solvay's "social comptabilism" [4] is to be attributed solely to the practical man's timidity and not to any strict proof of the weaknesses of the schemes, which has indeed not been forthcoming. All the banking theorists whose views are derived from the system of Tooke and Fullarton (and this includes nearly all present-day writers) are helpless with regard to Solvay's theory and others of the same kind. They would like to condemn them, since their own feelings as well as the trustworthy judgments of practical men warn them against the airy speculations of reformers of this type; but they have no arguments against a system which, in the last analysis, involves nothing but the consistent application of their own theories.

The third part of this book is devoted exclusively to problems of the banking system. There the theory of the elasticity of credit is subjected to a detailed investigation, the results of which perhaps render any further discussion of this kind of doctrine unnecessary.

Chapter 6: ENEMIES OF MONEY

1. Money in the Socialist Community

If a socialist society completely abolishes all property rights and distributes scarce goods and services according to a central plan, then there is no scope for even direct exchange (let alone indirect exchange) and therefore no room for money.

However, some socialist visionaries concede that even in their ideal society, people would retain ownership rights in personal consumption goods such as cigarettes, apples, loaves of bread, sweaters, and so forth. In this case, people would naturally engage in mutually beneficial trades, and ultimately would foster the development of money.

2. Money Cranks

Throughout the ages, reformers have blamed money for social ills. (The love of money is famously declared to be the root of all evil.) The hostility to gold and silver is particularly intense. Yet these reformers never explain their full vision of a world *without* money, for if they attempted such a description, the problems with their schemes would be obvious. merely for an "elastic credit system," which expands or contracts the money supply according to the community's "need for currency." According to this particular group of **money cranks**, the current money and banking system imposes an artificial scarcity by restricting credit and charging higher interest rates than necessary.

• Some socialists viewed money itself as a "dirty" product of the market economy, and believed that in a pure socialist society, there would be no need for it. However, as Mises explains, some of the more sophisticated theorists imagined that the workers in a socialist community would have property rights in consumption goods (and perhaps personal tools of the trade for skilled artisans etc.). However, what *cannot* be allowed in a socialist community—lest it become a system of capitalism—is private ownership in the large-scale means of production, such as farmland, factories, railroads, etc.

• Mises concedes that a socialist community that retained private ownership in personal consumption goods, could foster the emergence of genuine money. However, Mises is *not* here referring to the "labor certificates" envisioned by some socialist theorists. For example, we could imagine that socialist factory and farm managers hand out one certificate for every labor hour (of suitable quality) that each worker performs. Then, once the "crop" of output goods has been "harvested" from all the various factories and farms—including not just bottles of milk but also television sets and basketballs—the socialist leaders determine what fraction of the crop each certificate entitles the bearer to, based on the size of the harvest and the total number of certificates that were issued. Although many casual observers think that this is basically what money *is*—a claim on the "real output" of society—such a view is very superficial.

Actual money (as opposed to a money substitute) is not a claim on anything; it is its own good, but of course it is valued because of its expected purchasing power. If a fire destroys half of the crop, then the labor certificates will necessarily entitle their holders to one-half as much. But with one unit of money, it is not necessarily true that its exchange value in the market would drop by exactly one-half, and in any event the processes governing its purchasing power are completely different from those governing the "redemption power" of a labor certificate in a socialist community.

• When dealing with the last category of "money cranks" on page 94 , Mises explains that the mainstream economists of his day could not effectively refute those who claimed that a massive expansion of the money supply—in order to drive the interest rate down to zero—would bring about material abundance. Although most economists and practical businessmen shied away from such extreme proposals, they were merely the logical extension of the prevailing economic doctrines concerning money and banking. It would take Mises's own work, in particular his development of the **circulation credit theory of the trade cycle**, to adequately explode this variety of monetary crankishness.

Circulation credit theory of the trade cycle: The theory developed by Mises (in the present book) explaining the boom phase of the business cycle as due to the artificial expansion of bank credit, made possible by fiduciary media. The bust is then inevitable, as capital goods are malinvested during the boom.

Money cranks: Very naïve writers who believe that scarcity is an artificial institutional constraint, and that prosperity requires only a sufficient willingness to create more money and/or issue more bank credit.

. . . .

What **two trends** cause the emergence of indirect exchange to become inevitable? (p. 91)

Would the **isolated** household use money? Why or why not? (p. 91)

Do all socialists propose the complete abolition of money? (p. 91)

If the amount of "real output"—number of apples, TVs, heart surgeries, etc.—were to fall in half, would the purchasing power of money necessarily fall in half? (p. 92)

Does Mises endorse the banking theories of Tooke and Fullarton? (p. 94)