# 11. Money

"The general preoccupation with money led to several curious beliefs which are now so firmly rooted that one hardly sees how anything short of a collapse of our whole economic system can displace it. One such belief is that commodities — goods and services — can be paid for with money. This is not so. Money does not pay for anything, never has, never will; It is an economic axiom as old as the hills that goods and services can be paid for only with goods and services; everything which is paid for must be paid for out of production, for there is no other source of payment."

Albert Jay Nock.[1]

"Money, by means of which the whole revenue of the society is regularly distributed among all its member, makes itself no part of that revenue. The great wheel of circulation is altogether different from the goods which are circulated by means of it. The revenue of the society consists altogether of these goods, and *not the wheel which circulates them.*"

Adam Smith[2]

More books have been written about money than would stock a good-sized library, and, if the truth were told, most of them worthless, at least to the ordinary man or woman seeking an explanation of the phenomena surrounding their economic existence: the alleged 'scarcity' which the economists assure them is their permanent lot; inflation, by which their rulers, creators of this frankenstein monster, seem stupefied into helplessness; and the ever-increasing limitation of their freedom.

Money, the circulating 'wheel' of Adam Smith, which began as the 'instrument of commerce and the measure of value', has become the central preoccupation of our lives, individually and collectively, in our personal involvement in getting a living, and in the corporate activity of the society as public revenue and expenditure involving its manipulation and actual 'manufacture' by governments in the alleged interest of 'managing the economy'. It is, therefore, highly desirable in the process of understanding what are incorrectly termed 'economic problems', that myths surrounding money should first be destroyed.

Perhaps one of the few really valuable treatises on money is Ludvig von Mises's *The Theory of Money and Credit*[3], the following extracts from which will indicate its quality and relevance;

"The outward guise assumed by the question with which banking and currency policy is concerned changes from month to month and from year to year. Amid this flux, the theoretical apparatus which enables us to deal with these questions remains unaltered. In fact, the value of economics

lies in its enabling us to recognise the true significance of problems, divested of their accidental trimmings. No very deep knowledge of economics is usually needed for grasping the immediate effects of a measure; but the task of economics is to foretell the remoter effects, and so to allow us to avoid such acts as attempts to remedy a present ill by sowing the seeds of much greater ill for the future.'[4]

"The biggest variations in the value of money that we have experienced during the last century have not originated in the circumstances of gold production, but in the policies of governments and banks-of-issue. Dependence of the value of money on the production of gold does at least mean its independence of the politics of the hour. The dissociation of the currencies from a definite and unchangeable gold parity *has made the value of money the plaything of politics*. (Italics ours). Today we see considerations of the value of money driving all other considerations into the background in both domestic and international economic policy. We are not far now from a state of affairs in which 'economic policy' is primarily understood to mean the question of influencing the purchasing power of money."[5]

"All proposals that aim to do away with the consequences of perverse economic and financial policy, merely by reforming the monetary and banking system, are fundamentally misconceived. Money is nothing but a medium of exchange and it completely fulfils its function when the exchange of goods and services is carried on more easily with its help than would be possible by means of barter. Attempts to carry out economic reforms from the monetary side can never amount to anything but an artificial stimulation of economic activity by an expansion of the circulation, and this, as must be constantly emphasized, must necessarily lead to crisis and depression. Recurring economic crises are nothing but the consequences of attempts, despite all the teaching of experience and all the warnings of the economists, to stimulate economic activity by means of additional credit."[6]

That last statement is well borne out by the eventual demise of the Bretton Woods attempt to salvage 'the consequences of perverse economic and financial policies'. "In 1944, as the world was recovering from the effects of World War II, the heads of state from over 100 countries met at Bretton Woods (U.S.A.) to create an international monetary system that would unite the Western world, insure monetary stability, and facilitate international trade. Over the years since then the system has been plagued by dollar shortages and dollar 'gluts'; chronic deficits and chronic surpluses; perpetual parity disequilibria, 'hot money', capital flows and currency depreciation. By 1968, a 'two-tier' gold market was established in the midst of a gold crisis which, by 1971, culminated in the suspension of dollar convertibility together with a dollar devaluation against multilateral revaluations of most other foreign currencies." (Paul Stevens)[7]

Hans F. Sennholz, of the Department of Economics, Grove City College, Pennsylvania, also writing in *The Freeman,* in November 1969, on inflation in the United States up to that time, said: "To some, inflation denotes a spectacular rise in consumer prices; to others an excessive aggregate demand; and to at least one economist, it is the creation of new money by our monetary authorities. The disagreement among economists is more than an academic difference on the meaning of a popular term. It reflects professional confusion as to the cause of the inflation problem and the policies that might help to correct it."

It was this confusion among the economists that contributed as much as anything to 'the perverse economic and financial policies' which sent the heads of governments to the Bretton Woods conference. This same confusion persists today and its effects are seen in the inflation now raging around the world like an epidemic; there is no doubt, however, that the real culprits are the actual makers of policy, the politicians, whom the economists have too often sold themselves to serve.

This confusion stems in part from that general preoccupation with the shadow (money) instead of the substance (goods) with which this chapter opens; but not wholly so, for, as it is the main purpose of this work to show, there is a fundamental omission from the theories of the economists which upsets their equations and, hence, nullifies their conclusions. But before proceeding to a full discussion of this proposition it is necessary to clarify the general popular confusion over the role of money in the economy and to expose unequivocally the true cause of what are alleged to be 'monetary problems'.

The first essential is to keep clearly in mind the basic fact that money, as we are nowadays accustomed to it — in the form of inconvertible paper currency — is not, of itself, worth more than the paper it is printed on; that it is merely a convenient *means* of facilitating and expediting the movement of goods and service from seller to buyer in the market; that it, of itself, has no influence on prices, or on supply and demand. What does influence these is the deliberate contravention of the economic law of the market by government intervention in the interests of aggressive sections of the community, involving restrictions on the flow of goods, i.e., by tariff 'protection', by import controls, by subsidies or by taxation, or by the manipulation of the purchasing power of the money units by increasing their supply by note printing or by expansion of credit or manipulation of a fixed exchange rate.

Deliberate manipulation of the purchasing power of the money units has been practised, almost since the invention of currency, by kings and princes in the interest of their own treasuries, first by debasement of the actual metal content of coins in circulation. Later, on the introduction of paper currency (first introduced by China in the eleventh century A.D.), the way was open for this practise to be used extensively by governments as a way of financing

expenditure without having to apply the more open and more painful method of increasing taxation. The effect was, of course, the same, but not immediately *visibly* so to the bulk of the population.

This practice has now become systematised to the point where every government in the civilized world avails itself of the opportunities open to it through control of banking and money exchange, the results of which are now so bitterly being suffered in the form of world-wide inflation.

A most valuable book on the techniques of this modern system of currency manipulation is *How Money is Managed* by Paul Einzig.[8] It is described by the author as "An examination of the financial, economic, social and political purposes for which governments may use their power of influencing the movements of prices and other monetary tendencies, and the methods, traditional and modern, by which they may seek to achieve those purposes." This is a splendidly lucid, easy to read and understand, detailed description of the process by which the contravention of natural economic law has been effected by the substitution of human law in the interests of political policies, resulting in the corruption of the market, ever-increasing power of centralized government, the further enrichment of the rich and the increased impoverishment of the poor. The author does not put his conclusions in that precise form; his attitude is one of admirable impartiality in reporting the facts; but the implications are plain enough to the discerning reader.

Einzig sets out the 'static' and 'dynamic' functions of money, the static comprising the following five (technical) functions:

1. a medium of exchange
2. a means of non-commercial payment
3. a standard of value
4. a standard of deferred payment
5. a store of value

*None of these,* he says, *should normally give rise to any price trend or influence the basic economic trends in other ways*. Dealing with the dynamic aspects of money, he says: "Recent literature tends to represent money as something much more than a mere passive device . . . Contemporary writers attribute to it several additional roles of fundamental importance in the determination of economic trends. Foremost is the influence of money on the national economy through depreciation and appreciation or, what is the same thing, a rise or fall in the general price level. *There can be no such thing as a change in the general price level except under a monetary system.*"[9] (Italics ours.) Which is the same thing as saying that price trends are affected by manipulation of the money supply — by *management* of the monetary system in the interest of specific policies.

Earlier, he writes: "Under a system of free economy — as distinct from a planned economy under which the volume of production of various categories of goods is determined by the State authority — the quantity of goods produced is largely determined by the profit earned on them. This in

turn is determined by the prices obtained for them, compared with the cost of production. Prices again are determined by the relation between supply and demand. Conversely, supply and demand are themselves influenced by cost of production and prices. These tend to adjust themselves,

> "according to the quantities available for sale and the number of people who have the desire and the means to buy the goods, but in turn they also tend to effect an increase or reduction of supply or of demand according to the profit margin — if any — they leave to producers. In a free economy, movements of individual prices play, therefore, a very important part in determining production, distribution and consumption. And prices are expressed in terms of money. This means that money does much more than merely serve as a convenient technical device to facilitate the exchange of goods and as a unit of account by which the values of various objects can conveniently be compared. It is the medium through which the price mechanism in a free economy tends to establish a balance between cost of production and sale price, and between supply and demand."[10]

Again, he describes the static role of money as "a passive technical device" which "does not fundamentally affect the operation of the price system. Admittedly, if the level of prices of certain categories of goods or services should rise or fall substantially, the discrepancy in relation to other prices may give rise to major trends liable to upset the static equilibrium of the economy. *But such unsettling influences are not initiated by money in its capacity as a medium through which the price system operates. In that capacity money is an essentially 'neutral' device. It does not determine individual prices; they are merely expressed in terms of money.*" (Italics ours)[11]

But "with the aid of the modern monetary system", that is with 'management' of inconvertible paper money, "governments are in a position to spend well in excess of amounts raised by taxation. It is possible for them to raise very large amounts by borrowing. Thanks to the modern credit system, treasuries are now able to create conditions in which they can borrow practically any sum they require. The monetary system, therefore enables them to embark on costly economic, social, political and military policies which would be out of their reach financially were it not for the dynamic functions of money. Such policies are apt to affect fundamentally the economy of the community concerned. *For better or worse these dynamic functions of money enable governments to create a national debt running into astronomical figures.*" (Italics ours)[12]

> "The monetary system also provides the means by which the burden of such excessive indebtedness, public or private, *can be reduced in a comparatively painless manner through a depreciation of the monetary unit.* (our Italics) This may obviate . . . the necessity for reducing an intolerable burden of indebtedness through wholesale bankruptcy or repudiation."

"From the point of view of its technical functions it is essential to maintain a stable value of money to the highest possible degree. On the other hand, from the point of view of dynamic functions, it may be necessary in given circumstances to depart from stability . . . however deplorable this may appear from the point of view of its static functions."[13]

How well the 'managers' have learned their lessons in the dynamic uses of money is writ large across the face of the world today. The tiger is no longer 'in their tanks' but between their legs and is becoming as unmanageable as is predictable from its very nature.

In discussing 'management' in Britain up to 1951, Einzig shows that the volume of money "as represented by bank deposits" was "kept down by a combination of government policy and banking tradition". It was not kept down as rigidly as it was under the gold standard "when an expansion of the volume of currency and credit was liable to correct itself automatically by causing an outflow of gold leading in turn to a contraction of credit. *Under the existing system there is no technical arrangement that would prevent runaway inflation such as we have witnessed in other countries.*" (Italics ours)[14] The reader will need no prompting to reflect on how this situation has changed in the succeeding twenty-odd years. Einzig quotes Professor Robinson from an article contributed by the latter to *Lloyds' Bank Review* at the time: "Sterling is maintained sound not through any qualities inherent in the system, but through the wisdom and ability of those in charge of its management."[15] Surely it is more than time the wisdom and ability of the managers were challenged or, better still, time to dismantle the whole system and start again; and not merely in Britain.

In succeeding pages Einzig defines 'monetary policy' as: "The attitude of the political authority towards the monetary system of the community under its control," and proceeds to discuss the forms such policy may take and their effects on the economy concerned, giving examples of the disastrous consequences of some of the monetary policies adopted by rulers down the centuries, mostly under the 'necessity' of conducting wars. Later, he deals with such refinements of monetary policy as 'fiscal policy', 'banking policy' 'financial policy' and 'economic policy', and shows the difficulty of defining border-lines between them — inevitable in view of their basic inter-relationship once true *laissez faire* is abandoned and 'management' supersedes.

"The scope of monetary policy has widened immensely within the brief span of our lifetime" says Einzig. "The extent to which budgetary and non-monetary means are adopted largely if not entirely with an eye on the monetary situation has increased. Indeed . . . a school of thought has developed among economists and practical experts, especially in the United States, which advocates that monetary measures in the narrower sense of the term should be replaced largely by fiscal measures aiming at monetary ends.

In Britain and other countries physical controls are advocated . . . as substitutes for conventional measures of monetary policy. In so far as rationing, price controls, import and export controls, etc., affect the monetary situation their deliberate application to serve partly that purpose comes within the scope of monetary policy.''[16] And so the downward path is trod towards the pit of totalitarian rule. Lenin's famous dictum on currency debauchment, in the application of which Keynes proved himself to be so apt, if unintentional, a practitioner, has become the glaring red light by which mankind's faltering steps now feel their frightened way.

All because we have forgotten the fact, of which the statements at the head of this chapter remind us, that money's simple function is the facilitation of exchanges of goods and services; instead of which we have allowed this monstrous over-growth of 'dynamic' purposes to serve the ends of power-hungry politicians.

History is full of examples of the disastrous consequences of this lunacy and Einzig furnishes us with ample reminders in the course of his book. But perhaps the most dramatic presentation on the subject is the famous description by Andrew Dickson White[17] of the madness that possessed the rulers of France after the revolution of 1789, beginning with the issuing of non-convertible paper 'assignats' for the purpose of solving the problem of the unberable burden of public debt resulting from the misrule of Louis XVI, and ending with the coming to power of the dictator, Napoleon, in 1799, to 'save the Republic' from the blight that had descended on it coincident with the flooding of the country with a total of 40,000 million notes which had finally become utterly worthless.

Writing on the paradox of ever-increasing prices in a world supposedly enjoying the benefits of technological progress, Einzig says:

> ''Much has been written by economists about the question whether or not the monetary authorities should allow declining costs to produce their natural effect on the price level. In our days this dilemma seldom arises. Throughout modern history there has been an uninterrupted technological progress. It is reasonable to assume that ever since the beginning of the industrial revolution in the middle of the eighteenth century the cost of goods in terms of human effort has been declining. Nevertheless, temporary intervals apart, prices have been increasing. This is due in part to the rise in real wages that has been going on throughout the ages. Labour-saving devices cannot always lead to corresponding reductions in prices . . . The standard of living of employees and their wages requirements (sic) tend to rise simultaneously with technological progress and to absorb a large part of the savings in costs achieved as a result of that progress. Working hours tend to be shorter, and restrictive practices are apt to limit the output. Another reason why technological progress has failed to reduce prices is that, relatively brief intervals apart, the monetary trend has been distinctly inflationary. It is reasonable to assume that but

for the decline in the cost of production through technical progress the rise in prices would have been even more pronounced during the past fifty years. The decline in costs has been unable to cause a fall in prices but has to some extent moderated their rise. From time to time it has actually led to provisional setbacks in prices. For instance, during the inter-War period the mechanization of agriculture through the widespread use of tractors, combine harvesters, etc., brought about a declining trend in the price level. The monetary authorities sought to counteract this and aimed at maintaining a stable price level. The result was over-production which played a decisive part in the series of crises and the long depression of the 'thirties'."[18]

The only thing wrong with this argument is the fact that Einzig leaves out of account, like so many other brilliant writers in economics and allied subjects, the part played by the factor *rent*. A significant pointer to this vital omission may be seen in the further passage of Einzig's book in which he discusses a policy "aiming at lower prices" which "may be decided upon in an attempt to check a speculative boom" during which "a number of unsound ventures are bound to come into existence, and it is in the interest of the community that a large proportion of these should be forced into liquidation. A policy aiming at a lower price level automatically eliminates mushroom growths which have no *raison d'etre* except during periods of boom."[19]

It is scarcely necessary to point to the situation in which Australia, in company with the United States, Britain and elsewhere, finds itself in the 'seventies' of this present century, in which the thunder of collapsing financial structures is only a little louder than that of the buildings being ruthlessly destroyed in the pursuit — in the phoney name of 'progress' — of the fortunes derived from the traffic in land values.

On the international aspects of money management Einzig has some interesting things to say, of special significance in the present preoccupation with the search for the elixir of modern international life — a universal currency system, designed to save us all from the follies arising from the abandonment of the gold exchange system by which our grandfathers got along very satisfactorily. His chapter (11) 'Accumulating and Safeguarding Monetary Reserves' describes the historical process by which the present 'system' evolved, always strongly influenced by political rather than economic necessity. Henry VIII is shown to be a seasoned practitioner in this field. However, "even in our days the possession of a large monetary reserve makes for political prestige at home and abroad." It also, of course, is a formidable tool in the mechanism by which governments retain control of their citizens' affairs.

To the layman unversed in the jargon of 'monetary policy', money in the international sphere is enveloped in a mystique which he is compelled by his assumed ignorance to leave to the experts. Yet again, if only he would keep

steadily in mind the basic fact that foreign exchange is no more than the exchange of goods for goods in the course of international trade instead of within a single country, the true picture would emerge, i.e. that the mystique covers this mechanism by which governments intervene in and manipulate the business transactions and the property of their citizens in the name of such shiboleths as 'economic stability', the 'balance of trade', the 'maintenance of gold reserves', et al.

When a private citizen, or a company, does business with his counterpart in another country he finds it convenient to leave the financial settlement to a bank through the simple technique of bills of exchange which the bank will discount for him to save him the trouble and expense of going personally abroad to collect his money. With the natural, *unhindered* growth of international trade these transactions are multiplied millions of times and the volume of exchange settlements becomes equally large. The normal procedure for the banks involved, in this situation, for the simplification of exchange balances, was the shipment between them of gold bullion from time to time as required.

Governments were not slow to see the advantage available to them in enlarging the sphere of control over the behaviour of their nationals given them by this process; this was achieved by such devices as making it illegal for a private citizen to own, buy or sell gold, except in non-commercial form, setting up central reserve banks, into whose hands the private banks were compelled to place a proportion of their clients' funds (known as Statutory Reserve Deposits), regulating the amount of money an individual or company could export or import, and controlling their accumulated overseas funds for the governments' own purposes.

At the apex of this monstrous pyramid is the modern refinement of the manipulation of foreign exchange rates, the bloodless warfare in the interests of financial hegemony, by which the world is brought to the brink of financial catastrophe. (Example: The United States' attempt to maintain the dollar price of gold at the utterly unrealistic figure of $35 an ounce in order to refuse the right of Soviet Russia and other gold producers to benefit by the true gold market).

Von Mises says "Government measures designed to regulate the international movement of money in order to ensure the community shall have the amount it needs are just as unnecessary and inappropriate as, say, intervention to ensure a sufficiency of corn or iron or the like."[20] And in his chapter on 'The Stock of Money and the Demand for Money' he insists on the individual motivation towards the market as fundamental to an understanding of the problem of the demand for the valuation of money. In this he exposes the fallacy of 'macro-economics', the modern foundation on which the whole sorry edifice of international money control is built.

In his chapter 'The Principle of Sound Money'[21], von Mises sets out for all time in unambiguous terms the true function of money and the evil

consequences of tampering with that function in the spurious interests of governments. It is worth quoting in full as a fitting and comprehensive summary of most of the contentions of this present work:

> "As a system of peaceful co-operation under the division of labour, the market economy could not work without an institution warranting to its members protection against domestic gangsters and external foes. Violent aggression can be thwarted only by armed resistance and repression. Society needs an apparatus of defence, a state, a government, a police power. Its undisturbed functioning must be safeguarded by continuous preparedness to repel aggressors. But then a new danger springs up. How to keep under control the men entrusted with the handling of the government apparatus lest they turn their weapons against those whom they were expected to serve? The main political problem is how to prevent the rulers from becoming despots and enslaving the citizenry. Defence of the individual's liberty against the encroachment of tyrannical governments is the essential theme of the history of Western civilization. The characteristic feature of the Occident is its people's pursuit of liberty, a concern unknown to Orientals. All the marvellous achievements of Western civilization are fruits grown on the tree of liberty.
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> "It is impossible to grasp the meaning of the idea of sound money if one does not realise that it was devised as an instrument for the protection of civil liberties against despotic inroads on the part of governments. Ideologically it belongs in the same class with political constitutions and bills of rights. The demand for constitutional guarantees and for bills of rights was a reaction against arbitrary rule and the non-observance of old customs by kings. The postulate of sound money was first brought up as a response to the princely practice of debasing the coinage. It was later carefully elaborated and perfected in the age which — through the experience of the American Continental Currency, the paper money of the French Revolution and the British Restriction period — had learned what a government can do to a nation's currency system.
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> "Modern crypto-despotism, which arrogates to itself the name of liberalism, finds fault with the negativity of the concept of freedom.
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> The censure is spurious as it refers merely to the grammatical form of the idea and does not comprehend that all civil rights can be as well-defined in affirmative as in negative terms. They are negative as they are designed to obviate an evil, namely omnipotency of the police power, and to prevent the State from becoming totalitarian. They are affirmative as they are designed to preserve the smooth operation of the system of private property, the only social system that has brought about what is called civilization."

*NOTES FOR CHAPTER 11*

1. Albert Jay Nock: *Memoirs of a Superfluous Man.*
1. Adam Smith: *The Wealth of Nations*, Bk. 2, Chap. II, p254.
3. Ludvig von Mises: *The Theory of Money and Credit*; the Foundation for Economic Education Inc., New York, 1971, Jonathan Cape, London, 1971.
4. Ibid; from the preface to the English edition, 1934, p14.
5. Ibid; pp17/18.

5a. It should be noted that dependence on a "definite and unchangeable gold parity" is not essential to a properly functional money supply. The fact that "the value of money (is) the plaything of politics" does not justify this dependence. The effect of 'politics' on money policy is well stated by von Mises in the next quotation (note 6).

6. Ibid; p21
7. Paul Stevens: *Bretton Woods 1944-1971*; Article in *The Freeman*, Foundation for Economic Education, N.Y., May 1973.
8. Paul Einzig: *How Money is Managed*, Penguin Books, London, 1954.
9. Ibid; pp21/22.
10. Ibid; p20.
11. Ibid; p21.
12. Ibid; p24.
13. Ibid; p25.
14. Ibid; p33.
15. Ibid; p33.
16. Ibid; p43.
17. Andrew Dickson White: *Fiat Money Inflation in France*; The Foundation for Economic Education, New York, 1959.
18. *How Money is Managed*: Einzig; pp114/115.
19. Ibid; p115.
20. *The Theory of Money and Credit:* von Mises; p 182.
21. Ibid; p413.