Preface

I have always been an admirer of Ludwig von Mises (1881-1973) and long considered him the greatest economist of the 20th century. He was also a charming and a modest person. He would have never considered himself infallible. And he wasn’t. After a long study, soul-searching and hesitation I called attention to points where in my opinion Mises was wrong. With a great deal of diffidence and humility I defend my position against attacks from the post-Mises Austrians.

Accentuating the negative

I have always felt that the theory of gold money, as presented by Mises and even more so by Hayek, is a ‘negative theory’. Friedrich A. Hayek almost goes as far as saying that the gold standard is a necessary evil; there would be no need for it if governments could be trusted. According to Mises it is the temptation to tamper with the value of the monetary unit that has made the gold standard indispensable. In this way growth in the stock of money is tied to the profitability of gold mining. Mises thought it was necessary to add that “the gold standard is not a perfect institution: there is no such thing as perfection in human affairs.” His position is motivated by the Quantity Theory of Money. Consequently he fails to distinguish between the *value of gold* and the *purchasing power of gold* which, from the point of view of Menger, are two entirely different concepts.

Positive theory of gold

In my view there is no need to be apologetic about the gold standard. Rather, there is need for what I call in want of a better word a 'positive theory of gold'. I am offering such a positive theory. My main criticism of Mises, Hayek, and many other great economic thinkers going all the way back to Ricardo centers around the fact that they have all missed the *point of contact between gold and interest*. More specifically they have missed the *point of contact between gold and the ‘curse of aging’*. Man’s surplus of mental and physical powers will one day give way to deficit and he knows it. He prepares for the day when he has to draw on his savings. Provided, that is, he has any: that central planners and central bankers have not embezzled it. There is no insurance against this peculiar misfortune other than gold hoarding. None of this is mentioned by Mises. In fact, Mises unfairly ridiculed John Fullarton by calling his reference to gold hoarding in reaction to the suppression of the rate of interest *“Deus ex machina”.*

In the view of most economists gold was hit upon as a suitable material out of which the monetary unit can be made by accident. Gold is heavy and shiny an ideal symbol of opulence. Their failure to connect gold with immortality, a counterpoint to senescence, is all the more

curious since Carl Menger, the founder of deductive economics had already developed the theory of marketability (*Absatzfähigkeit*) that we shall call by its more precise name, *marketability in the large,* in the 19th century. He established the fact that the origin of money was a prolonged process of evolution selecting the good that is more marketable in the large than any other. Then *indirect exchange* emerged to supplant *direct exchange* (barter) as the most marketable good in the large has become the preferred good which market participants wanted to get in exchange for their wares.

But there is a second aspect of marketability that we call *marketability in the small*. This concept was not isolated until the end of the 20th century. It is the catalyst to explaining the origin of interest. The most marketable good in the small is the *most hoardable.* It was also a prolonged process of evolution before the *direct conversion* of income into wealth and wealth into income through isolating the good that is more marketable in the small than any other was replaced by *indirect conversion*, that is, the *exchange* of income for wealth and wealth for income. This is the starting point of our theory of interest. Interest appears as the measure of the efficiency of exchange over hoarding and dishoarding.

The disequilibrium theory of price

Mises was a professed quantity theorist. He readily admitted that the supply/demand *equilibrium theory* of price formation is a far cry from reality but, as he says, we have nothing better to replace it. As a penetrating study of Menger's work reveals, we actually do: the *disequilibrium theory* of price based on the variation of the bid/asked spread as a function of quantity traded.

Mises' addiction to the Quantity Theory of Money is all the more curious since he was an adamant opponent of positivism, a synonym for panphysicalism, a doctrine asserting that there is no other method of scientific inquiry than empiricism. Historically, the Quantity Theory of Money is the most damaging fruit of panphysicalism. Menger's 'Quality Theory of Money' is infinitely superior: the value of money, far from being determined by its *quantity* is, rather, determined by its *quality*, namely, the quality of marketability.

Self-liquidating credit

The concept of self-liquidating credit has been around since the great scholars on banking theory introduced it in Germany in the 19th century. The source of self-liquidating credit is definitely *not savings*. Paradoxically, it is *consumption*, giving rise to discounting bills and to the discount rate. The discount rate should be thought of as the manifestation of the momentum that consumption of goods most urgently demanded by the consumers, imparts to production. To Mises demand is one dimensional. Although he agrees that Say's Law is valid: as long as people want to eat, there will be employment opportunities so that everyone who wants to

earn wages, can. But he would not agree to the following extension of this proposition: as long as people want to eat, there will be an opportunity for everyone of character who has mastered the four rules of arithmetic to start his own retail business virtually without capital thanks to the universal availability of self-liquidating credit. Street vendors can survive, indeed prosper, in front of hypermarkets. It's just a matter of moving goods from the producers to the consumers in the most efficient way. In more details: the movement of finished consumer goods can be financed, without advancing a single gold coin, namely, with the most marketable financial instrument second only to the gold coin: the real bill.

From blockading trade to blocking bills

This fact is not merely of theoretical interest. For us, children of the 21st century, it is also a matter of preserving our civilization. The disastrous experimentation with irredeemable currency has reached the point of no return. Our civilization is at stake, and the only way to save it is through the gold coin standard *cum* real bills financing of trade. The bill market is the clearing house of the gold standard without which it cannot long survive. This is why the British effort to go back on the gold standard in 1925 failed. After the peace treaty following World War I the victorious Entente powers could no longer *blockad*e Germany's foreign trade. In their wisdom they instead *blocked* the circulation of international gold bills of exchange that used to finance it. In doing so they shot themselves in the foot as their own producers and consumers were equally handicapped by the forcible abolition of the multilateral trading system, that is, the international gold-bill market. The victors in their neurotic fear of German efficiency forced the straitjacket of the bilateral trading system on the whole world. This was tantamount to going back to barter without realizing it.

Destruction of the Wage Fund

In actual fact, it was even worse. The Entente powers unwittingly destroyed the *Wage Fund* out of which most workers before World War I had been paid. They produced *semi-finished* goods which could not be sold for 90 days while they 'matured' into *finished* products. The forcible abolition of the international gold-bill market made it impossible to continue paying wages to a great many workers. Economists were blind to see the dire consequences, the coming disaster in the form of the Great Depression of the 1930's and the unprecedented wave of unemployment in its wake. The only exception was Heinrich Rittershausen, but his warnings were dismissed as German chauvinistic propaganda. The gold standard was made the whipping boy responsible for the catastrophic unemployment. That judgment has never been reviewed and it is still outstanding. Just one economist, Wilhelm Röpke, had the courage to stand up and say that the fault lay not with the gold standard, but with those in whose care the gold standard

was entrusted. We may add that the trouble was not with the gold standard *per se*, but with the decision to castrate it − by removing its clearing house, the bill market.

The ultimate extinguisher of debt

History is repeating itself. The present crisis is a gold crisis. Gold, the only *ultimate* extinguisher of debt, has been unceremoniously deposed and exiled from the monetary system. In consequence debt in the world can only grow. Without gold there is simply no way to reduce the size of *total* debt. What they call debt reduction nowadays is just shifting debt from individuals to banks, from banks to governments. Governments at large, through their central banks, shift it to the U.S. Treasury where the buck stops. So the price of *reducing* debt in a peripheral country is the *increasing* of the irredeemable debt of the most indebted country at the center. This is a most inane notion ever taking root among informed and intelligent people, raising questions how scores of Nobel-laureates can treat it with respect.

To camouflage the unlimited accumulation of unpaid and unpayable debt, excess debt is being kicked upstairs. It unobtrusively keeps accumulating as ‘sovereign debt’ of governments. Nevertheless, the holy name ‘sovereign debt’ does not neutralize its increasing toxicity, nor does it compensate for its decreasing liquidity.

The central bank is ordered to do “all it takes”, that is, buy as much sovereign debt as necessary to contain deflation. However, money-printing cannot keep up with the collapsing velocity of monetary circulation. The world is blindly rushing into another Great Depression and is facing another unprecedented wave of unemployment. The monetary authorities do see this coming. But whatever they do, the action they take is counterproductive. Deflation, which we may define as the spontaneous collapsing of the velocity of monetary circulation, continues and deepens − despite the printing-spree. Central banks may print paper money to their hearts’ content, but they are utterly helpless when it comes to controlling the velocity of circulation. They could not divine what people will do with the freshly printed paper money put into their hands (dropped from a helicopter). Central banks pray and hope that people spend it on goods to prevent prices from falling. It is all in vain. Speculators front-run the central bank in buying Treasury bonds. The appeal of riskless profits is irresistible. They know the central bank is committed to a policy of open-ended bond purchases. Speculators pre-empt it in buying the bonds first.

Risk-free speculation

The hare-brained schemes of Keynes and Friedman assume that there is only one conceivable reaction people may have to the stimulus of open-ended money-creation is: open-ended

buying of goods − as falsely predicted by the Quantity Theory of Money. They failed to notice the fly in the ointment. The fly that has escaped their attention is risk-free speculation induced by the well-advertised open-market purchases of government debt by central banks. It was hailed as a way to 'fine-tune' and 'micro-manage' the increase in the aggregate reserves of the banking system. We need not go into investigating the validity of the claim whether this is feasible or reasonable. It is sufficient to point out its fatal flaw: it ignores risk-free profits to which it inevitably gives rise. Rather than controlling the fall of prices, the policy of open market operations contributes to the fall of interest rates through inordinate purchases of bonds by the speculators in competition with the central bank. However, falling interest rates, as this treatise proves, erodes and ultimately destroys capital, thus deepening deflation and hatching depression.

The stealthy and illegal introduction of open market operations by the Federal Reserve in 1922 has led to the ruination of the world economy. It did not take a century to accomplish this feat. It does more damage to civilization than the NKVD and the Gestapo combined. It kills with invisible bullets.

In their obsession with the Quantity Theory of Money Keynes and Friedman forgot that the lure of risk-free profits would take precedence to the lure of consumption. People respond to the stimulus of open-ended money creation with open-ended purchases of bonds – before they give thought to open-ended purchases of goods. The Fed sows inflation – only to reap deflation.

After all is said and done, a *durable* regime of irredeemable currency which Keynes and Friedman were so eager to establish remains a pipe dream.

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