THE LOGIC OF FREE MARKET MONEY

AN A PRIORI THEORY ANALYSIS

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"Human reason so delights in constructions, that it has several times built up a tower, and then razed it to examine the nature of the foundation. It is never too late to become wise; but if the change comes late, there is always more difficulty in starting a reform."

—Immanuel Kant (1783), Prolegomena To Any Future Metaphysics, p. 2.

"To hasty observation the authoritarian state and Social Democracy appear as irreconcilable opposites between which there is no mediation."

—Ludwig von Mises (1919), Nation, State and Economy, p. 211.

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Preface

The purpose of this treatise is to revisit the economic and ethical aspects of the concept of *free market money* – its nature, origin, evolution and devolution – on the basis of *a priori theory*, or: *apriorism*. A priori theory provides truth claims (knowledge) which are self-evident (*non*-hypothetically true), and which can be validated independent of observation (sensory experience).

ON METHODOLOGY

An illustrative example of true a priori knowledge is the "law of contradiction", one of the "laws of thought" known to be universally true as taught by *logic* (with logic being "the autonomous science of the objective though formal conditions of valid inference".[1]) Consider the following example: *The ball is red* and *The ball is not red* cannot both be true at the same time. It is impossible to think otherwise. That is, the law of contradiction is absolutely true, irrespective of time and place, it cannot be denied without causing an insoluble intellectual contradiction.

The methodological approach employed in this treatise is taking recourse to *a priori theory* in the tradition of the work of Ludwig von Mises (1881 – 1973). Mises re-constructed economics along the lines of what he called *praxeology: the logic of human action*. Praxeology rests on the irrefutably true *axiom of human action*. The axiom of human action qualifies as an *a priori synthetic proposition* in the terminology of Immanuel Kant (1724 – 1804). That is, praxeological analysis consists of the elaboration of the logical implications of the concept of human action; in the field of economics it deduces *a priori true knowledge* from the axiom of human action.

For instance, values, ends, means, choice, preference, time, profit and loss, all categories well known to be at the heart of economics, are implied in the axiom of human action; so is, for instance, also the institution of private property, as is the law of diminishing marginal utility, time and time preference.

Misesian a priori theory stands, to say the least, in stark contrast to the *positivist-empiricist-falsificationist* doctrine dominating in today's mainstream economics. The positivist-empiricist-falsificationist doctrine models economics along the lines of the natural sciences, where *if-then hypotheses* are formulated and tested vis-à-vis (historical) observation in an effort to obtain and validate knowledge. On the one

[1] Nagel, Cohen (2002), An Introduction To Logic And Scientific Method, p. iv.

hand, positivists-empiricists deny the possibility (or existence) of *a priori* truth claims. On the other hand, economic propositions are seen to be at best hypothetically true, as they can never be validated once and for all with certainty (on the basis of testing). It will be argued in this treatise that the positivist-empiricist-falsificationist doctrine is an inconsistent and untenable epistemological position in the fields of economics. It shouldn't therefore be surprising that praxeology yields conclusions which may differ from those derived in the mainstream economics framework.

FREE MARKET MONEY

The concept of free market money denotes money that is chosen by the free demand for and the free supply of money in unhampered markets. It was put forward, and most prominently so, by Friedrich August von Hayek (1899 – 1992) in his "Denationalisation of Money" (1976). Therein, Hayek laid out an analysis which was – by the economic and political standards of his time – fairly contentious: He ascribed economies' susceptibility to recurrent boom-and-bust, inflation and, ultimately, depression to the age-old government monopoly of the issuance of money. Hayek pointed out that governmental monopolization of money production would not only be incompatible with the general principle of freedom of enterprise, he also raised doubts as to whether government monopoly money would be compatible with upholding the free market economy: "If we want free enterprise and a market economy to survive (as even the supporters of a so-called 'mixed economy' presumably also wish), we have to choice but to replace the governmental currency monopoly and national currency systems by free competition between private banks of issue."[2]

While having been a scholar of Mises up to the late 1920s, Hayek hadn't subscribed to praxeology, and his (later) works took actually side with the methodology of the *critical rationalism*, the epistemological philosophy advanced by Karl R. Popper's (1902 – 1994) – which, in turn, can be interpreted as a(n advanced) form of empiricism. It is therefore all the more interesting that Hayek's advocacy of free market money can nevertheless be given a rigorous praxeological basis. In fact, a praxeological analysis brings to the surface that free market money is actually the *only* economically-ethically justifiable form of organizing monetary affairs; and that a government controlled money regime is economically and ethically irreconcilable with upholding the free market society.

[2] Hayek (1976), Denationalisation of Money, p. 130.

Making such a case can of course be expected to invite sharp criticism, to say the least, especially so as the government-sponsored fiat money regime has become the “norm” and is nowadays widely seen as the unchallenged “state-of-the-art” order of society’ monetary affairs. A commodity, or free market, money regime, in contrast, is widely seen as being “outdated” and actually “unworkable”. It is here where the praxeological methodology can help to stimulate the debate by opening up a new theoretical perspective.

PRAXEOLOGY AND FREE MARKET MONEY

The praxeological analysis shows that fiat money hasn’t developed “naturally” out of the free market, but that it must have been established through coercion. What is more, fiat money is inflationary; it enriches a few at the expense of many others; it increases society’s consumption at the expense of savings; it causes mal-investment and “boom-and-bust” cycles; it leads to a situation of over-indebtedness on the part of governments and banks in particular (something that has been widely ignored in the Austrian economics framework) and ends in an economic crisis on a grand scale according to the Austrian Monetary Theory of the Trade Cycle (MTCT):

Against these insights several important questions arise, with perhaps the most important being this one: Could free market money – which is from the praxeological viewpoint economically and ethically superior to fiat money – be an option for guiding monetary reform? When addressing this pressing and contentious issue the analytical focus must zoom in on the institution of *government*, or state, for that matter. It was Mises’s most prolific scholar Murray N. Rothbard (1926 – 1995) who, on the basis of praxeology, advanced an entirely new theory of government. He characterised the state as the *monopolist of law and security*: an agency that exercises a territorial monopoly of ultimate decision making and the right of taxation.

Taking recourse to Rothbard’s *libertarian argumentation*, it will be demonstrated that the state is actually incompatible with private property. The state is neither required to create private property, nor does it follow from the right and need for protection of individuals and their property that protection (code of law, police, security) should or could be effectively provided by a monopolist of jurisdiction and taxation; such a conclusion would actually be a *non sequitur*. It is praxeologically impossible for an individual to surrender the ultimate decision making over his person and property once and for all to such a *monopolist*. For this would be in violation of the *a priori* of private property. This libertarian line of argumentation will be reconciled with the supreme principle of *right* and *just* law as put forward by Immanuel Kant (1724 – 1804).[3]

Against these findings it will be argued that if there is *public ownership of the monopoly of law and security with the right to tax* (as is the case under a *parliamentarian democracy*), such an agency will logically keep expanding at the expense of individuals' private property. Most important, an expanding government will, and necessarily so, sooner or later monopolize money production, that is ending commodity money and replacing it with its own fiat currency. In other words: The monopolisation of money production is the *logical* consequence of *public ownership of the monopoly of law and security* with the right to tax.

This, in turn, opens up a praxeological explanation of the *recurrence* of boom and bust, the characteristic feature of the Austrian MTCT. The series of boom and bust is typically explained by monetary policy making the same mistake over and over again (that is increasing the quantity of fiat money through bank circulation credit expansion). However, a rigorous praxeological explanation will be advanced – namely the theory of *collective corruption*.[4] As government keeps expanding under a fiat money system, it will make ever greater numbers of the population and businesses economically and financially dependent on (the expansion of) the state and its fiat money regime. A government-sponsored fiat money regime will bring about an economic incentive structure that will make people develop, and increasingly so, an *encompassing interest* in government at the expense of their support for adhering to the principles guiding the free market. This holds true in particular in times of economic and financial crises: The majority of people prefers interventionist policies for defending the government-sponsored fiat money system (in the form of taxation, regulation, prohibitions, nationalization, etc.) over "letting it go bust", that is allowing market forces to restore the economy back to equilibrium.

The praxeological theory of collective corruption does not only explain *why* there is a recurrence of boom and bust, it also explains *why* a fiat money regime must lead to an erosion, in the extreme case destruction, of the free market society, being

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[3] "Every action is RIGHT and JUST, the maxim of which allows the agents freedom of choice to harmonize with the freedom of every other, ACCORDING TO A UNIVERSAL LAW." Kant (1871), Metaphysics of Ethics, p. 177; italics and small caps in the original. And further: "The law or universal rule of right is, So act that the use of thy freedom may not circumscribe the freedom of any other (i. e., if thy act or maxim were made imperative on all) … ." Ibid, p. 178; italics and small caps in the original.

[4] On the idea of collective corruption see Polleit (2011), Fiat Money and Collective Corruption.

(gradually) transformed into an interventionist-socialist order, as Hayek had insinuated. In fact, this insight echoes Mises's words in "The Theory of Money and Credit" (1912), at a time when his methodological work hadn't been published: "It would be a mistake to assume that the modern organization of exchange is bound to continue to exist. It carries within itself the germ of its own destruction; the development of the fiduciary medium must necessarily lead to its breakdown."[5]

The praxeological analysis also reveals why returning to free market money faces such high, perhaps insurmountable, hurdles once a fiat money regime has been put into place and taken off. Mancur L. Olson (1932 – 1998) argued that if and when politically powerful *special interest groups* can and do influence public policy in their favour, it will require extreme events, or crises, to bring about (structural) reforms. These extreme events offer societies with an opportunity to "clean institutional slate."[6] While differing in many respects from Olsons' theory, the praxeological explanation developed in this treatise takes side with Olson in that a(n economic and financial) crisis emerges if and when government violates private property.

Over the last decades, various proposals have been put forward from Austrian economists for returning to free market money. When viewed against the backdrop of the theoretical insights pointed out in this treatise, it should be clear that a return to free market money would have, as a necessary condition, to go hand in hand with a return to free market society ("private law society"): a societal organization in which there is unconditional respect for individual private property rights. Mises, as early as 1923, had already argued along the same lines: "The belief that a sound monetary system can once again be attained without making substantial changes in economic policy is a serious error. What is needed first and foremost is to renounce all inflationist fallacies. This renunciation cannot last, however, if it is not firmly grounded on a full and complete divorce of ideology from all imperialist, militarist, protectionist, statist, and socialist ideas."[7]

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[5] Mises (1953 [1924, 1912]), The Theory of Money and Credit, p. 409.

[6] See Olson (1984 [1982]), The Rise and Decline of Nations, p. 225. According to Olson, *special interest groups* in democratic societies are a driving factor behind economic decline. These vested interests are unwilling to surrender their privileged position, even in the face of a crisis. The onset of a significant crisis resulting in collapse could displace these vested interests, Olson argued, allowing for widespread changes to institutions and rules.

[7] Mises (2006), The Causes of the Economic Crises and Other Essays, p. 44.

"Praxeological knowledge makes it possible to predict with apodictic certainty the outcome of various modes."[8] However, praxeology does not, and cannot, make exact predictions as far as future affairs are concerned. We do not know what the future will hold in store for the world economic and financial system after having been on an unfettered international fiat money regime for decades. In any case, it seems to be important to bring forward a rigorous and comprehensive praxeological analysis for theoretically identifying and understanding the true cause of current monetary induced crises – as only a correct diagnosis of its root cause of the problem can pave the way towards formulating constructive solutions. It is in this sense that this treatise hopes to make a positive contribution to the current economic and political debate, certainly encouraged by Immanuel Kant's words: "It is never too late to become reasonable and wise; but if an insight comes late, it will be that much harder to make use of it."[9]

[8] Mises, (1996), Human Action, p. 117.

[9] Kant (1949), Prolegomena To Any Future Metaphysics, p. 2.