AGAINST MISTAKEN MORALIZING

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THE MORAL CASE AGAINST NONCOMMODITY MONEY

My many years teaching at the University of Virginia brought me under the influence of Rutledge Vining and his writings (e.g., his 1984). As Vining explains, sensible discussions of reform focus on observed deficiencies of the institutions in question and on how their operation might be made more satisfactory. To Hans-Hermann Hoppe, joined by Jörg Guido Hülsmann and Walter Block (1998), the central deficiency of our existing monetary institutions is their fraudulence, their radical immorality. An adequate reform would abolish fiduciary media and restrict the performance of monetary functions to hard money (commodity money like gold) or to certificates and deposits backed 100 percent by hard money actually held in reserve.

Hoppe, Hülsmann, and Block (HHB) appear to take the phenomenon and concept of money as too basic or too familiar to require close examination of money's functions. They refer to money as if it consisted or properly would consist of pieces of property: things, objects, commodities. They repeatedly use expressions like "money (gold)," "property (money)," "money property (gold)," "property (appropriated goods)—whether consumer goods, producer goods, or money—," and a "fundamental distinction between property and a property title." "Titles to money are—and should be—backed by money in the same way and for the same reason as titles to cars are and should be backed by cars. . . . a title to money backed by assets other than money is a contradiction in terms" (p. 25).

HHB observe that demand claims on money, notably banknotes and demand deposits, circulate as if they either were money in the above narrow sense or else purported to be titles to it. Here, as they see it, is the flaw in fractional-reserve arrangements. It is not possible for more than one person to hold full and exclusive title to the same piece of property; it is not possible for valid titles to exist in greater volume than the total amount of property they supposedly represent. The pretense of

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doing something physically or logically or legally impossible, especially in hope of drawing advantage from this pretense, is immoral. A contract of this kind and purpose is just as morally and legally invalid as a contract involving square circles or (in the present state of biological knowledge) flying elephants.

Defenders of fractional-reserve banking (e.g., Selgin 1988; Selgin and White 1996) have rejected a more traditional charge of fraudulence by observing that practically no holder of a checking account supposes that his bank is safeguarding his money in its vault in the form of actual coins and currency and by further observing that bankers and their depositors understand what is going on and agree to these practices because they find them advantageous to themselves. HHB outflank this defense with their new charge of fraudulence summarized above: no agreement purporting to do the impossible can be morally and legally acceptable.[1]

HHB distinguish between the multiplication of fraudulent titles to money and the legitimate sale of permits to park in a lot that could not accommodate all permit-holders' cars at once. The permits do not purport to be exclusive titles to slots within the parking lot. Instead, they are mere licenses to hunt for currently unoccupied slots.

My central quarrel is with HHB's conception of money in both the narrow and broadened senses—as commodities or as titles or claims to commodities. Their conception presumably traces to a favorite strand of Austrian economics. On Carl Menger's account of the origin of money (1892, and in greater detail in his 1970), money evolved in historical stages from commodities found particularly convenient in barter transactions. As Menger would agree, however, the essence of a developed institution is not necessarily specified by its genesis or most primitive form; to suppose that it *is* commits the "genetic fallacy." Institutions do evolve, even radically; and changes in degree can cumulate into changes of kind. Modern money is an example: it simply is not and does not even purport to be physical commodities or titles to them.

One might try to analogize banknotes and demand deposits to HHB's parking permits: instead of purporting to be exclusive property titles, they are authorizations to demand redemption in narrow money in expectation that claims actually exercised will normally be satisfied but in recognition that far from all claims could be satisfied at once. I do not insist on this interpretation, however, for it too fails to capture the essence and functions of money in the modern world.

MONEY AS A CLEARING DEVICE

Money serves clearing, which is the multilateral offsetting of claims and obligations against one another. Claims acquired by delivering goods or services to some

[1]Huerta de Soto (1998, esp. chaps. 1–3) musters impressive scholarship, especially in legal history, to document points essentially the same as those of HHB. Still, no amount of scholarly documentation of points that, even if valid, would fail to establish the position at issue can make those points relevant after all.

trading partners pay for goods or services received from other trading partners. Schumpeter offers a simple example (1970, p. 227): a surgeon operates on a singer, the singer performs at a lawyer's party, and the lawyer handles a legal case for the surgeon. If the three services happened to have the same market value, the three parties might arrange to recognize that they were square with one another without transferring any money or property.

Clearing might just conceivably be accomplished by the all-around centralized recording and offsetting of transactions; but the complexity and costs of such an operation in the vast modern economy and the loss of the information otherwise generated in decentralized market transactions, as well as its Big Brother aspects, rule such centralization out. Not even being realistically feasible, it serves only as a pole of comparison and expository device. Decentralized record-keeping is more practical and economical. In this decentralized process, coins, notes, and bank accounts are memoranda or tickets, so to speak—receipt vouchers for the values of goods and services delivered and generalized claims on whatever the market will offer for sale at prices that transacting parties will agree on. A fuller description must also recognize gifts, loans, financial intermediation, and capital accumulation; the role in economic calculation of the unit of account in which the tickets are denominated; and the flexibility and other advantages afforded by such a system. Such a description does not deny but penetrates more deeply into money's role as medium of exchange.

How do we know that its function as a clearing device is central to modern money? We can understand that function by studying the writings of Kocherlakota (1998), Moini (1999), Shah and Yeager (1994), and Yeager (1999), and especially the writings of Kuenne (1958) and Schumpeter (1956). More directly, we can understand that central role by observing and pondering the forms that money takes and the functions that it performs every day in the world around us.

UNIT OF ACCOUNT, BASE MONEY, AND PEGGING

The tickets or memoranda that constitute modern money must, as mentioned, be denominated in some unit of account, some pricing unit. Traditionally that unit was some quantity of gold or silver. In the United States nowadays, it is a fiat unit, the dollar of base money issued by the Federal Reserve system (in the form of Federal Reserve notes and deposits in the Federal Reserve banks) and in relatively small volume by the Treasury (as token coins). The unit of account is essentially the scruffy dollar bill, whose value depends on nothing more than the demand to hold it (and its fellow components of base money) confronting a limited supply. All other countries now have essentially the same system, except for countries whose money units are defined by or pegged to one or a basket of the units—fiat units—of other countries.

The purchasing power of such a unit is ill-defined and precarious, determined as it is by a changeable demand confronting a supply whose adequate management strains the expertise of the central bankers and their impermanent capacity to resist political pressures. Other circumstances contribute to making this supply–demand situation precarious: the bulk of U.S. base money consists of paper notes, the bulk of which, in turn, is held abroad (partly for lubricating the drug trade); most of the rest of the base money is held as reserves, directly and indirectly, against vastly pyramided amounts of bank accounts and near-moneys; the demand for existing base money depends partly on government impediments to use of alternative units of account and media of exchange; and financial innovation keeps developing new methods of accomplishing payments without money of any traditional sort, thus further reducing the relative importance of base money.

All of this the Federal Reserve has to cope with, somehow. The situation may fairly be described as preposterous. One trouble is the dollar's undependable purchasing power. Another is the possibility of bank runs and resulting disruptions. More conspicuous in recent decades has been the counterpart of this fragility on the international scene–the crises that occur when market participants lose confidence in the exchange rate at which a country's currency is pegged to other currencies on the basis of merely fractional reserves of gold and foreign exchange. Palliatives to such domestic and international difficulties are available and have been attempted, although at the cost of bringing disadvantages of their own. Recognizing these difficulties, which do indeed involve fractional reserves, is no concession on my part; for I have long been pointing them out (citing economic history and economic theory more than moral principle).

REFORM

How inadequate a reform it would be to require 100-percent reserves of fiat base money of the present unsatisfactory sort! Requiring 100-percent reserves of this or a more satisfactory base money, though conceivable, is not the only possibility; indeed, for reasons alluded to below, it is not even realistically possible. A more fundamental reform would reject as any sort of model both our existing fiat-money system and a 100-percent-reserve system. It would abolish the pegging of some kinds of money (and near-moneys) to merely fractional reserves of any money of some more "ultimate" kind. It would abolish any distinction between base money and the more ordinary and voluminous kinds of money by abolishing base money itself. (All money would be "inside money," in the terminology of Gurley and Shaw 1960, chap. 3 and *passim*; and no particular reserve medium would exist to be held in either 100-percent or fractional amounts.) The suggested reform would carry to the final degree the already observed dwindling relative importance of base money. Instead of being defined by any base money, the unit of account would be defined directly by some commodity or, better, by an assortment of goods and services, leaving the issue of money and other financial instruments to competitive private enterprise. Among other advantages, such a system would enhance money's role in financial intermediation through improving its operation—subsidiary, of course, to its medium-of-exchange function—as a vehicle of genuine saving.

(The academic literature on these possibilities has begun finding some resonance in the world of affairs, as in a 1999 speech by Mervyn King, deputy governor of the Bank of England.)

Before urging their own 100-percent-reserve reform, HHB should consider the difficulties of implementing it and the consequences of even trying to do so. Here, without repeating them, I allude to familiar discussions (e.g., Selgin 1988; Selgin and White 1996) about the strong incentives impinging on all participants to practice fractional-reserve banking—if a distinct base and reserve money exists at all—and to devise innovative ways around any prohibition of that practice. Entrepreneurs in a free-market economy work to ferret out inefficiencies, and the exclusive use of precious metals (or warehouse receipts for them) as memoranda or tickets in the decentralized economy-wide clearing process would be a glaring inefficiency. Draconian interventions would be necessary to fight evasions of any such requirement.

STYLE OF ARGUMENTATION

Would HHB really persist in advocating their reform even if it would entail misery and if an alternative reform would conduce to prosperity and happiness? Do they really mean to reject, as not only economically unsatisfactory but downright immoral, any monetary and payments system other than one rooted in transfers of monetary commodities (like little metal disks fully worth their face values) or of claims fully backed by such commodities? That is what HHB do seem to be saying. If that is not what they mean after all, let them strive for greater clarity.

My questions are not at all meant to scorn morality in policy discussions. That a particular measure would infringe basic principles of morality is a practically conclusive objection to it. Morality is indeed important—but *why*? It is important because, as Ludwig von Mises explained, morality is essential to social cooperation and thus to people's chances for happiness.

What I object to is assertions about morality linked to misconceptions and word games concerning money and its functions, property, and titles. Modern money does not consist and does not pretend to consist of commodities. Banknotes, demand deposits, and the new means of payment being multiplied by modern technology do not even purport to be titles, whether valid or false, to underlying property.[2] What money is and what functions it performs are far better described by elaborating on the concept of record-keeping and clearing device.

[2]HHB appear to use the concept of title or property right with exaggerated sharpness. Titles are often fragmented or fuzzy. Titles may be split up by different aspects of an object or piece of real estate, time-sharing arrangements, and easements of various kinds. And who, for example, owns the right either to fill the air in your immediate neighborhood with loud sounds or to prevent such sounds? Suppose that the owner of a quantity of (fungible) gold coins agrees to dilution of his title in return for advantages that he considers more than adequate compensation. No question of a pretense at multiple *full and exclusive* titles to that quantity of coins need arise.

HHB's present style of argumentation parallels, by the way, Hans Hermann Hoppe's well-known claim to derive the whole libertarian policy stance from his so-called logic of argumentation and Murray N. Rothbard's attempt to derive the same stance from the Lockean axioms of self-ownership and first appropriation. All are attempts to derive sweeping conclusions essentially from one or a very few moral axioms. Moralizing does have its place, but it is no substitute for detailed economic analysis of existing institutions and of the likely operating properties of contemplated reforms.

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