MvP Book Abstract #7

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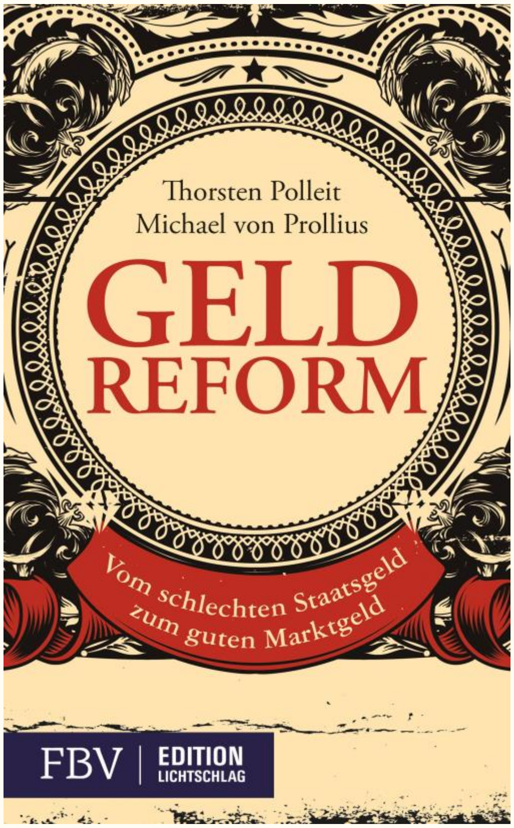
Geldreform: From Bad State Money to Good Market Money

A Monetary Reform Proposal based on Austrian School Economics



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One-Sentence Summary

This comprehensive analysis presents the theoretical foundations and practical strategies for transitioning from the destructive state monetary system to a free market money system based on competitive currencies, demonstrating how the current fiat money regime systematically undermines economic prosperity and individual liberty while offering concrete reform proposals grounded in Austrian School economics.

About This Book

Publication Details:

- **Author:** Thorsten Polleit and Michael von Prollius
- **Title:** Geldreform: vom schlechten Staatsgeld zum guten Marktgeld
- **Publisher:** Lichtschlag Buchverlag (1st and 2nd edition), FBV (3rd edition)
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- **Format:** 288 pages (3rd ed.)

Genesis and Methodology:

This book emerged from a spontaneous collaboration between two economists following their presentations at a Liberal Institute colloquium in Zurich. During a shared taxi ride to the airport, Thorsten Polleit suggested transforming their individual presentations into a joint work. The resulting collaboration proceeded largely through online "ping-pong" exchanges, creating a unified Austrian School critique of state money and blueprint for monetary reform.

Author's Note:

Michael von Prollius notes that his position has evolved since the first edition toward advocating for a completely free monetary system with competitive currencies, requiring only the elimination of the state monopoly on money production.

Book Abstract No.7

Geldreform: From Bad State Money to Good Market Money

A Monetary Reform Proposal based on Austrian School Economics Introduction

The central question guiding this investigation is: **How did Christianity manage to develop from a localized Jesus movement into a major institutional church and ultimately into the state religion of the Roman Empire within approximately 400 years?**

I. The Nature and Function of Money

Core Principles of Money

Money serves fundamentally as the universally accepted medium of exchange, facilitating productive and peaceful cooperation among individuals. However, this beneficial function depends entirely on whether the money is "good money" (produced in accordance with free market principles) or "bad money" (produced through violations of market principles).

The Single Function Doctrine

Following Ludwig von Mises' groundbreaking 1912 analysis, the authors establish that money performs only one primary function: serving as a medium of exchange. The commonly cited additional functions—unit of account and store of value—are merely derivative aspects of the exchange function, not independent roles.

This insight has profound implications for monetary policy. The question "How much money does an economy need?" receives a clear answer: any existing quantity of money is sufficient, since money only facilitates exchange. What matters is not the quantity but how money is produced and circulated.

The Law of Diminishing Marginal Utility Applied to Money

Money, like any other good, is subject to the law of diminishing marginal utility. The first monetary unit received provides greater additional utility than subsequent units. This principle explains why increasing the money supply necessarily reduces money's exchange value—a logical consequence that mainstream economists often ignore in their calls for monetary expansion to match economic growth.

The Coordination Function of Prices

Prices do not measure values but simply indicate exchange ratios at which transactions have occurred. Attempts by central banks to stabilize prices through monetary manipulation inevitably distort the crucial coordination mechanism of the market, leading to misallocations and economic crises.

II. The Austrian Theory of Money's Origin

Carl Menger's Market Evolution Theory

Carl Menger demonstrated in 1871 that money emerged spontaneously from barter through market processes, without any state intervention. In natural exchange economies, the difficulties of achieving the "double coincidence of wants" gradually led market participants to adopt certain goods as indirect media of exchange.

Mises' Regression Theorem

Ludwig von Mises solved the apparent circularity in explaining money's value through his regression theorem: money must have originated from a commodity with intrinsic value. The demand for money today derives from its exchange value yesterday, which can be traced back to the point when a commodity first acquired monetary function.

This theorem proves that purely fiat paper money could never have emerged through voluntary market processes. Paper money exists only because states severed the connection between currency and commodity money through what amounts to systematic expropriation.

Historical Evidence: The Predominance of Precious Metals

Throughout history, precious metals—particularly gold and silver—repeatedly emerged as preferred money due to their unique properties: durability, divisibility, homogeneity, scarcity, and intrinsic value. These characteristics allowed them to fulfill monetary functions while integrating seamlessly with market principles.

III. The Nature and Causes of Inflation

True Definition of Inflation

Inflation is not rising prices but the increase in money supply. Rising prices are merely a possible symptom of monetary expansion. This distinction is crucial because it reveals inflation's true nature as a redistributive mechanism that benefits those who receive new money first (Cantillon effect) at the expense of those who receive it later.

The Systematic Misdiagnosis

Modern economics' focus on consumer price indices obscures inflation's redistributive effects and ignores asset price inflation. When money supply grows while goods production increases, prices may remain stable, but this doesn't eliminate inflation's redistributive consequences—it merely makes them invisible.

Government as Inflation's Source

States and their central banks are solely responsible for inflation. In a pure commodity economy, generalized price inflation would be impossible. The claim that external factors (oil prices, wages, speculation) cause inflation serves only to deflect responsibility from monetary authorities.

The Destructive Social Effects

Inflation undermines the peaceful, voluntary nature of market exchange by making transactions beneficial only for some participants. It constitutes a hidden tax that redistributes wealth from money holders to those who first receive newly created money, violating the fundamental principle of voluntary cooperation.

IV. Free Market Money and Free Banking System

Principles of Free Market Money

In a free market monetary system, market participants choose what to accept as money without state intervention. Money emerges through voluntary supply and demand, creating a natural selection process that produces the highest quality medium of exchange.

The Free Banking Framework

Free banking completely separates deposit and lending functions:

- **Deposit Function:** Banks serve as custodians (warehouses) for money, charging fees for storage and security services
- **Lending Function:** Banks intermediate between savers and borrowers using actual savings, not newly created money
- **No Money Creation:** Banks cannot expand money supply through credit creation

Addressing Common Objections

The book systematically refutes standard objections to free banking:

- **Currency Chaos:** Competition would quickly establish one or few dominant money forms, likely precious metals
- **Insufficient Banking Services:** All current banking services would remain available under private competitive provision
- **Economic Instability:** Eliminating artificial credit creation would end boom-bust cycles

V. The Historical Path from Sound to Fiat Money

The Classical Gold Standard (1815-1914)

Despite imperfections due to state monopolies and central banking, the gold standard provided relative monetary stability and facilitated unprecedented global economic integration. This era demonstrated the benefits of international monetary coordination based on commodity money.

World War I and Monetary Destruction

Governments abandoned gold convertibility to finance war expenditures through monetary expansion, violating citizens' property rights and destroying the international monetary order. The war's monetary financing demonstrated states' systematic preference for inflation over taxation.

The Bretton Woods System (1945-1971)

This pseudo-gold standard maintained only limited convertibility for governments, not private citizens. Its collapse in 1971 when Nixon closed the gold window completed the transition to purely fiat money globally.

The Era of Unlimited Fiat Money (1971-present)

Since 1971, all major currencies operate as unbacked state money, creating unprecedented peacetime inflation and recurring financial crises of increasing severity.

VI. The Political Economy of State Money

Why Money Became Nationalized

States monopolized money production not for economic efficiency but to facilitate deficit financing. The progression from taxation to borrowing to monetary expansion represents the path of least political resistance for government financing.

The Financing Preferences of Government

All government financing ultimately reduces to taxation:

- **Direct taxation:** Politically visible and resisted
- **Borrowing:** Shifts costs to future taxpayers
- **Monetary expansion:** Hidden taxation through inflation

Inflation proves most attractive politically because its costs remain largely invisible to the general public.

The Role of Interest Groups

Following Mancur Olson's analysis, concentrated interests (large banks, industrial corporations) successfully lobbied for central banking systems that serve their interests at the expense of the general public.

VII. Central Banks as Inflation Engines

The Myth of Central Bank Independence

Despite claims of political independence, central banks consistently pursue policies that serve state fiscal needs. The ultimate test of independence—choosing between government bankruptcy and currency destruction—has never been faced under the current system.

The Mechanics of Money Creation

Central banks create money through:

- Credit expansion to commercial banks
- Purchase of government securities
- Direct asset purchases ("quantitative easing")

The fractional reserve system amplifies this money creation through commercial bank lending, creating enormous leverage ratios that make the system inherently unstable.

The "Too Big to Fail" Problem

State money systems inevitably create banking behemoths that become systemically important, forcing governments to bail them out during crises. This moral hazard encourages excessive risk-taking and concentrates financial power.

VIII. Austrian Business Cycle Theory

How State Money Causes Crises

Artificial credit expansion drives interest rates below their natural market level, determined by society's time preference. This triggers malinvestment in capital-intensive projects that become unprofitable when credit expansion inevitably ends.

The Impossible Task of Central Planners

Central bankers face the same knowledge problem as socialist central planners: they cannot know how much money an economy needs or what interest rates should be. Market processes, not bureaucratic decisions, must determine these crucial variables.

The Interventionist Spiral

Failed interventions create pressure for additional interventions, leading societies down the path from free markets toward socialist planning. As Mises demonstrated, there is no stable middle position between free markets and complete state control.

IX. The Path to Over-Indebtedness

The Debt-Growth Dynamic

State money systems systematically encourage debt growth exceeding income growth. Artificial credit expansion creates temporary booms that collapse when malinvestments become apparent, but instead of allowing necessary liquidation, authorities respond with additional credit expansion.

Chronic Government Deficits

Data from the US, Japan, and Eurozone show persistent government deficits accompanied by declining interest rates—precisely the pattern Austrian theory predicts will lead to unsustainable debt accumulation.

The Mathematics of Unsustainability

When debt grows faster than income, eventual collapse becomes mathematically certain. Lowering interest rates merely postpones the reckoning while increasing its ultimate severity.

X. Credit Crisis and Bankruptcy

The Deflationary Correction

In a sound money system, credit contraction following malinvestment serves as a necessary correction mechanism. However, state money systems lack a natural anchor (like gold reserves) to stop deflationary spirals, making authorities terrified of allowing any deflation.

Government Bankruptcy Dynamics

The book analyzes how chronic deficit spending leads to sovereign debt crises, using examples like Argentina and the emerging Greek crisis of 2009-2010. The violation of European Union treaties in the Greek bailout demonstrates how debt crises erode legal constraints on government action.

XI. Hyperinflation: The Ultimate Monetary Catastrophe

Hyperinflation as Policy Choice

Hyperinflation results from government decisions to monetize debts when other financing methods fail. The German hyperinflation of 1921-1923 exemplifies how political inability to raise taxes or cut spending leads to monetary destruction.

The Social Destruction of Hyperinflation

Beyond economic damage, hyperinflation destroys social cohesion, moral standards, and political institutions. It represents the ultimate failure of state money systems and typically precedes currency reform or political revolution.

XII. The Return to Sound Money

Principles of Monetary Reform

Any viable monetary reform must satisfy both economic efficiency and ethical requirements. Only free market money meets these criteria by respecting individual property rights and allowing voluntary cooperation.

Reform Proposals Analyzed

The book examines three major reform strategies:

1. Mises' Gold Standard Restoration

- Immediate end to monetary expansion
- 100% gold backing for any new money creation
- Market determination of new gold-currency parity

2. Hayek's Currency Competition

- Abolition of state money monopoly
- Free competition among currency providers
- Market selection of optimal monetary media

3. Rothbard's Practical Transition Strategy

- Immediate backing of existing money supply with central bank gold reserves
- Transition to 100% reserve banking
- Complete privatization of banking system

Implications of Reform Calculations

Using 2009 data, 100% gold backing would require:

- **United States:** $6,382 per ounce (M1) or $31,716 per ounce (M2)
- **Eurozone:** €12,915 per ounce (M1) or €27,071 per ounce (M3)

These calculations reveal the enormous monetary expansion that has occurred under fiat money systems.

XIII. Contemporary Relevance and Critical Assessment

Enduring Austrian Insights

The book's Austrian School analysis provides crucial insights for understanding contemporary monetary problems:

Institutional Design: Central banks cannot possess the knowledge necessary to optimize money supply and interest rates—only market processes can provide this coordination.

Crisis Causation: Recurring financial crises stem not from market failures but from systematic distortions created by state money systems.

Political Economy: The alliance between governments seeking easy financing and banks seeking privileges explains the persistence of destructive monetary institutions.

Reform Necessity: Attempting to preserve state money systems through increased intervention only delays and amplifies eventual collapse.

Current Policy Implications

The authors' analysis suggests that contemporary policies following the 2008 financial crisis—quantitative easing, zero interest rates, massive government bailouts—represent exactly the wrong response. Instead of addressing root causes, these interventions perpetuate and amplify the underlying contradictions of state money systems.

Limitations and Critiques

While the Austrian analysis provides powerful insights, several aspects merit critical examination:

Transition Costs: The book acknowledges but may underestimate the massive redistributive effects of monetary reform, which could create severe political resistance.

International Coordination: Free banking systems might face significant challenges in international trade and finance without addressing coordination mechanisms.

Practical Implementation: The detailed mechanics of transitioning existing financial institutions to free banking principles require further development.

Contemporary Monetary Innovation: The analysis predates cryptocurrency and other monetary innovations that might affect free market money evolution.

XIV. The Competitive Currency Vision

Beyond Classical Gold Standard

The book's ultimate vision transcends simple gold standard restoration to envision genuine monetary competition where market forces, not government decree, determine what serves as money. This represents a fundamental reconceptualization of monetary systems.

Integration with Free Market Order

Free market money naturally integrates with broader principles of market economics:

- Voluntary cooperation replaces coercion
- Property rights receive absolute protection
- Entrepreneurial discovery replaces bureaucratic planning
- Competition ensures service quality and innovation

The Moral Dimension

The authors emphasize that monetary reform represents not merely technical improvement but moral necessity. State money systems inherently violate individual property rights and enable systematic wealth redistribution through deception.

XV. Conclusion: The Choice Between Freedom and Tyranny

The Fundamental Alternative

The book presents monetary reform as part of the eternal choice between liberty and tyranny that Alexander Rüstow identified as central to human history. State money systems inevitably expand government power and undermine the institutional foundations of free society.

Urgency of Reform

Continuing the current trajectory leads inexorably toward:

- Escalating financial crises
- Expanding state control over economic life
- Erosion of individual liberty and property rights
- Potential hyperinflation and currency collapse

The Market Alternative

Free market money offers the only sustainable path toward:

- Monetary stability without government intervention
- Elimination of artificial boom-bust cycles
- Protection of individual savings and property
- International economic coordination through voluntary exchange

Legacy and Future Directions

This work represents a significant contribution to Austrian School monetary theory by translating abstract principles into concrete reform proposals. The collaboration between Polleit and von Prollius demonstrates how Austrian economics can address contemporary policy challenges while maintaining theoretical rigor.

The book's emphasis on competitive currencies anticipates later developments in monetary theory and practice, including cryptocurrency emergence and growing recognition of central banking's limitations. Its moral framework—emphasizing the ethical requirements of monetary systems—provides enduring guidance for evaluating monetary institutions.

Most importantly, the work demonstrates that monetary reform is not merely technical adjustment but fundamental requirement for preserving free civilization. The choice between state money and market money ultimately represents the choice between tyranny and freedom that confronts every generation.

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About the Author

Michael von Prollius is a German historian, economist, and author specializing in the intersection of ideas, institutions, and historical development. He holds degrees in history and economics and has conducted extensive research spanning ancient history, economic thought, political philosophy, and contemporary policy analysis.

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