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# Cultural consequences of monetary interventions

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**Résumé** : Hayek et Keynes sont communément perçus comme étant les antipodes d'un des grands débats macroéconomiques du 20e siècle. Cependant ils partageaient un certain nombre de convictions relatives à la théorie monétaire, telle sur les effets nocifs de la thésaurisation et sur les effets désirables d'une offre de monnaie flexible qui s'adapte à la demande de monnaie. Dans le présent article nous allons souligner quelques-unes des conséquences culturelles qui résultent d'une expansion permanente de l'offre de monnaie. Nous allons nous concentrer sur le cas spécifique de l'expansion du crédit, au centre de l'évolution monétaire des deux derniers siècles, et plus particulièrement encore, sur l'expansion du crédit poussée à un niveau tel qu'il en résulte une inflation-prix permanente.

**Abstract**: Hayek and Keynes are usually perceived as antipodes in one of the grand macroeconomic debates of the 20th century. But they also agreed on some basic issues of monetary theory, most notably on the harmful character of money hoarding and the desirability of a flexible money supply to offset or neutralise changes in the demand for money. In our paper we highlight some of the cultural implications of a permanent expansion of the money supply. We will focus on the specific case of credit expansion (ex nihilo creation of money through credit) which has held centre stage of the monetary evolution of the past two hundred years and, even more specifically, on credit expansion pushed to such an extent that it entails permanent price-inflation.

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# Cultural consequences of monetary interventions

J.G. Hülsmann*

Friedrich August von Hayek and John Maynard Keynes are usually portrayed as antipodes in one of the grand macroeconomic debates of the 20th century. But they also shared a number of convictions related to the working of a monetary economic and to desirable monetary practices and policies. These agreements sprang from the fact that they received from their respective teachers, Alfred Marshall and Friedrich von Wieser, the "orthodox" monetary conceptions of the Banking School (Poulon 2000, Hülsmann 2007). Both Hayek and Keynes were raised to believe in the expediency and even necessity of a money supply that flexibly adjusts to the variations of the demand for money. Both of them were raised to appreciate policy-induced expansions of the money supply at least to some extent. In the context of the vigorous economic growth of the western economies after 1800, the doctrine of the Banking School vindicates such expansions on a massive scale.

This agreement is intriguing. It suggests that the debates between Hayek and Keynes were milestones of a larger and older intellectual tendency which today, as then, was an undisputed given even for the intellectual antipodes. This raises the question of the relative importance of these debates as compared to the overall tendency. Hayek himself had argued, on another occasion, that the common ground shared by apparent antipodes is more important than the disagreements. His case in point were the common views of Auguste Comte and G.W.F. Hegel – two very unlikely intellectual bedfellows – which were part and parcel o the emergence of 19th century positivism. Hayek wrote:

> The discussions of every age are filled with the issues on which its leading schools of thought differ. But the general intellectual atmosphere of the time is always determined by the views on which the opposing schools agree. They become the unspoken presupposition of all thought, and common and unquestioningly accepted foundations on which all discussion proceeds. (Hayek 1979, p. 367)

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At the heyday of the Hayek-Keynes debates, the western world still considered an environment of stable prices to be the norm from which a well-ordered economy would deviate only under the exceptional circumstances of a war or other such calamity. The inter-war period witnessed the last attempt of the West to return to the "normal" pre-war price level. This attempt was abandoned with the onset of WWII. From then on, prices have increased without interruption all over the western world (see Figure 1 for the UK).

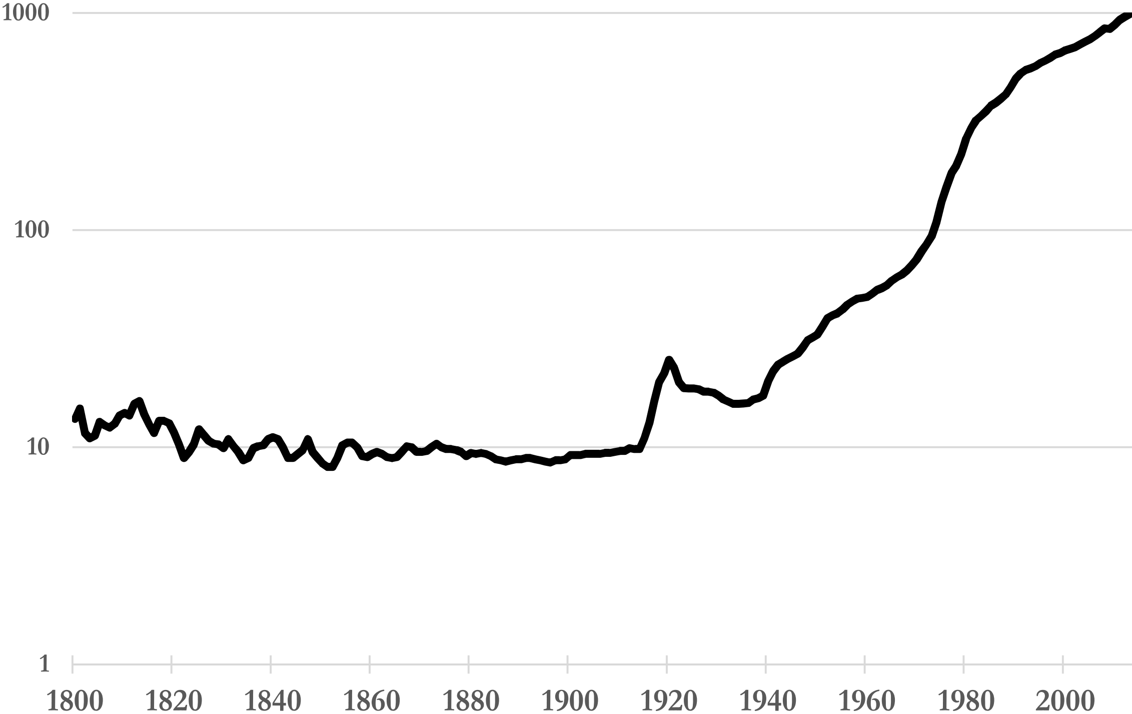



**Figure 1**

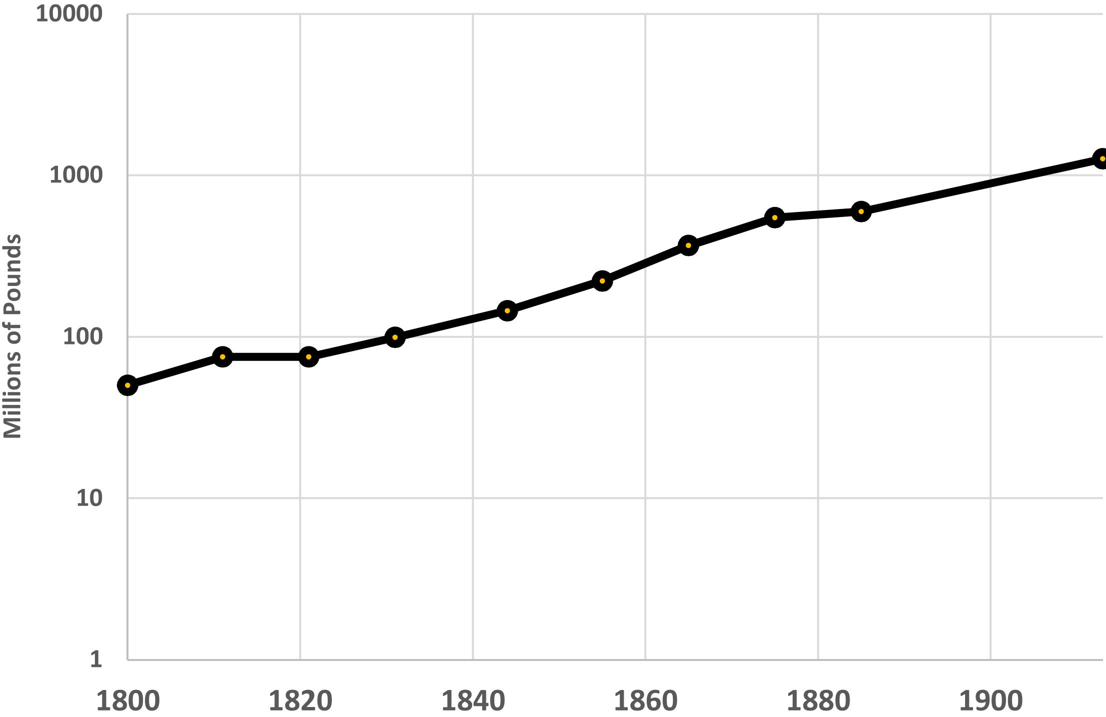
**Evolution of Consumer Prices in the United Kingdom, 1800-2013**

*Data source:* ONS, dataset MM23, Long term indicator of prices of consumer goods and services; Jan. 1974=100

The visible change in the evolution of the price level has all but monopolised the attention of most commentators. However, the relatively recent experience of permanent price-inflation is merely an offshoot of much longer (but largely subliminal) experience of permanent expansions of the bank money supply through credit expansion.[1] In the case of the UK, the latter were well under way during the 18$^{th}$ century, even they did not yet

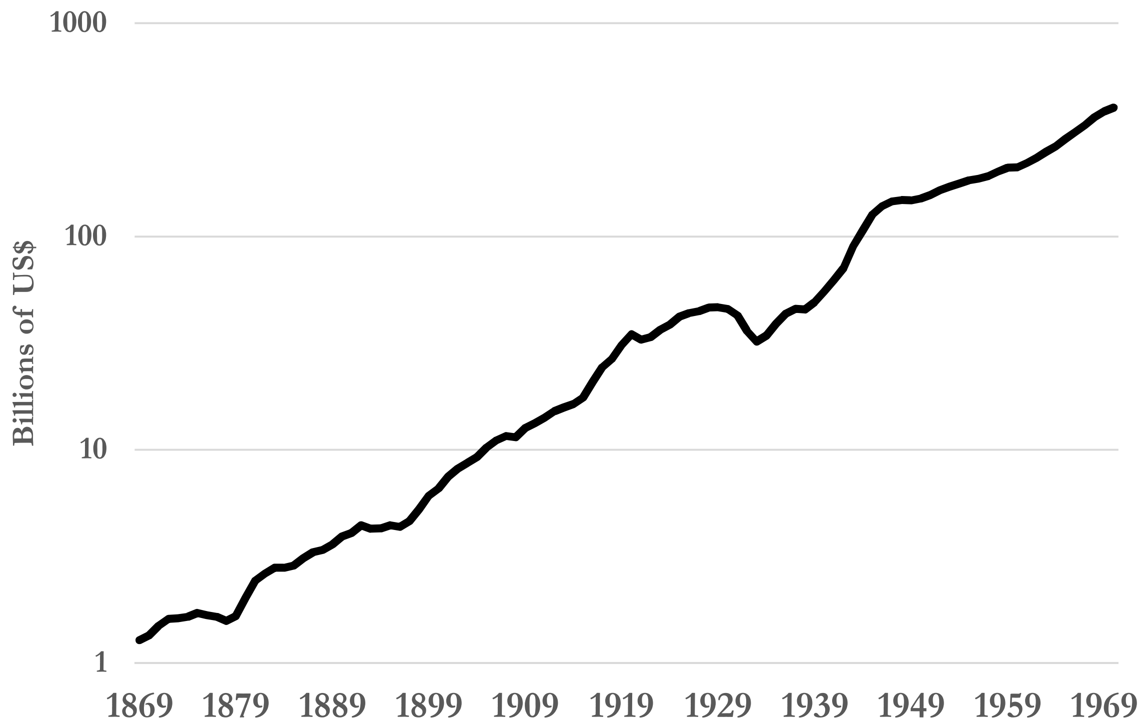
[1] On the concept of credit expansion see Mises 1953.

affect the overall money stock, as bank money replaced the (hitherto dominant) silver and gold coins. In the 19th century, however, the overall money stock began to increase at an average annual rate of about 3 percent (see Figure 2) and this increase would eventually accelerate during the 20th century.




**<u>Figure 2</u>**
**Evolution of M1 in England and Wales, 1800-1913**
*Source:* : R.E. Cameron et al., *Banking in the Early Stages of Industrialisation* (New York: OUP, 1967), p. 42

The same evolution of monetary conditions can be observed by and large in all other western countries. In the case of the US (see Figure 3), we observe a vigorous and permanent monetary expansion that can be traced back at least to the Civil War. As in the case of the UK, this expansion went in hand with permanently rising prices only after WWII.




**<u>Figure</u>**
**Evolution of M2 in the US, 1867-1970**
*Source:* Historical Statistics of the United States (1975), series X415, X417

Thus we have a long-standing process that is likely to have shaped economic customs, economic psychology, and even the mentality of the population. We propose to call these cultural repercussions the "inflation culture."

Surprisingly, this subject has received no systematic analysis from economists and historians alike. Economists from William Gouge, Charles Carroll, and Carl Knies in the 19th century to Ludwig von Mises, Josef Schumpeter and Melchior Palyi in the 20th century have incidentally lamented the moral and cultural implications of a permanent expansion of the money stock, without going into any noteworthy detail. Economic historians such as Andrew White have sometimes drawn attention to the same phenomenon, but none of them has ventured into studying it systematically.[2]

The first discussion of the subject seems to be in Hülsmann (2008, chap. 13). There we emphasized in particular that government-imposed increases of the money stock promote

[2] The second part of White (1896) bears the promising title "The breakdown in morals" but a closer look reveals that the author only tangentially deals with this topic.

the growth of centralized political powers, be it on the regional, national or even international level. They enable the financing of particularly destructive government activities that have no popular backing, such as going to war and pursuing a misguided economic policy. They facilitate loan financing at the expense of equity financing, and in the process create growing material and mental dependency of the citizens. As we have shown, the inflation of the money stock can be used to subsidise the welfare state and thereby facilitate immoral behaviour such as drug-taking and divorce, undermining the moral cement that ultimately holds society together. Finally, the sustained loss of value of intangible money creates very strong incentives to invest in financial products and to continually monitor one's portfolios. As a result people become much more materialistic and dependent than they would be in a competitive monetary system.

In 2008, our list of the cultural and spiritual consequences of inflation was by no means complete, and we are not attempting to write an exhaustive account this time either. This subject is so extensive that it could fill a whole book on its own. In the following we will focus on some of those aspects of inflation culture that *indirectly* result from a permanently increasing price level – which corresponds to the conditions that have prevailed in the western world roughly speaking as from World War II; and which *directly* spring from the particular incentives prevailing in a debt economy.

It will be helpful to start off our analysis with the help of an example (section 1) and then highlight how the debt economy promotes short-termism and haste (section 2), insatiability (section 3), ugliness especially in architecture (section 4), rationality traps (section 5), and willing dependence and politicisation of society (section 6).

## *1. The Origins of Inflation Culture*

If Peter saves $500 every month in cash, after twenty years he will have accumulated $120,000 and can buy himself an apartment or a small house. In the meantime he lives in rented accommodation, for a monthly rent of let's say $600. This is how things would usually be handled in a natural monetary order based on precious-metal base monies.[3] In such a setting, house prices would tend to remain static or even decrease slightly, so that the purchasing power of cash savings would be preserved or even increase. As an

[3] On the distinction between natural monetary orders and monetary systems see Hülsmann (2008, chap. 14).

alternative, Peter may invest his monthly savings into a low interest rate life insurance or building loan contract. He can thereby either shorten the time he has to wait to purchase a home or accumulate an additional next egg.

By contrast, in a price-inflationary monetary system there is a strong incentive for all interested market participants to buy the house they desire right away with the help of a mortgage. Let us look at the situation of one of these market participants, say, Paul. He is just as interested as Peter is in buying a house that is currently on offer for $120,000. However, Paul lives under an inflationary monetary system. He anticipates that in twenty years his income, as well as the property price, will be twice as high as it is now, while the purchasing power of a money unit will have fallen by half. In these circumstances, it is not worth saving cash at all. There remains the option of investing his savings in financial products, because in so doing he could obtain compensation for the declining value of money. If he chooses high-risk investments, he will have to spend a great deal of time educating and keeping himself informed, and monitoring his portfolio, in order to reposition it if necessary. He will also need a good deal of luck.[4] If he chooses a safer investment instead, he will have to accept *fixed* interest rates. But then price inflation can thwart his plans, because it may indeed rise even higher than he currently expects. Therefore Paul will in all likelihood choose a third option. He will take out a mortgage of $120,000 and service it, say, with monthly payments of $1,100, which would be equivalent to annual loan costs of about 9 per cent. In this way his obligations are limited from the start, while he might even profit due to a possible sharply rising price-inflation rate. Even in the short run he is no worse off than Peter, as his combined monthly budget for accommodation and saving is just as high.

In the long term Paul's situation actually seems to be somewhat better than Peter's, because after 20 years Paul's house will be worth $240,000. So if everything goes as planned, then Paul will have a higher income *and* a more valuable house. He appears to be enriching himself through debt. This appearance is deceptive, however. To be true, in the presumed inflationary economic system, the money price of the house increases to double its original value. This does not however necessarily mean an improvement *relative to all*

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[4] This is a very rare combination of skills and interests. Most private individuals are much less adept than the professionals, and this usually translates into more conservative investment decisions. For the case of household saving behaviour in France see Séjourné (2009).

*other goods*. If the prices of all other goods also double, then it does not help Paul at all that he now owns a house worth $240,000. If he sells it, he can buy exactly the same amount of goods from the proceeds as Peter. Paul would indeed be richer in monetary terms, but measured against real goods he would be no better off than Peter.

However, it will not usually come to even this neutral result. In an inflationary economic system it is very unlikely that Paul will be the only one with the idea of obtaining a mortgage to buy a home. The same reasons that move *him* to take this step also tempt *other* market participants to go into debt early in life, in order to buy property and other durable consumer goods. Precisely the same reasons also prompt the *sellers* of these goods to demand higher prices. This implies that the prices of durable goods tend to be higher – both in monetary terms and also relative to all other goods – in an inflationary economic system than in a natural monetary order. In other words, there is no way Paul can buy a house equivalent to Peter's for $120,000. For the same money, he gets a worse deal. To buy a comparable object, he has to dig deeper into his pocket or he will have to take on more debt.

We can see a shift here in the macroeconomic balance between product markets and asset markets.[5] The incomes achieved through production of goods and services decline relative to asset prices. In an inflationary money system, Paul either has to work longer or harder or else save more, in order to afford the same assets which Peter, in a natural money system, can already buy after a relatively short time. But there are three more characteristic ramifications we can recognize here as well.

First, Paul has more difficulty compensating for a possible loss of assets. As we have seen, in an inflation-prone economy, revenues tend to be lower relative to asset prices. Thus it takes longer to build up savings in order to buy real estate or company shares. Paul must therefore be more careful than Peter to avoid losses wherever possible. He will tend to spend more time than Peter studying the way asset markets work, in order to keep up-to-date on the current market developments and to adjust his portfolio to the changing conditions. In short: Paul will tend to have more materialistic interests and views than

[5] See the more detailed analysis in Hülsmann (2014).

Peter. If he owns financial products, his material well-being will be more dependent on the good conduct of other people than Peter's.

Second, Paul tends to finance his purchases differently from Peter. While the latter usually saves first and then buys, Paul will buy first and then save to pay off his debts. (It is of course also possible for Paul to save first and buy later in an inflation economy; but as we said this assumes that he is an especially good or an especially fortunate investor.) This is another reason why Paul will therefore tend to be more dependent on other people than Peter will be.

Third, Paul has every reason to be quick about his credit purchase. This is especially true if, as time passes, money incomes rise and interest rates fall. Such tendencies increase manifold the credit-financed demand for assets. In order to get hold of a house or a bundle of financial assets for as low a price as possible, Paul has to make the purchase as soon as he can.

Of course, these consequences do not only affect individuals like Paul. In an inflation economy they affect more or less all members of society. Everyone *tends to* act like Paul and thus a culture of inflation comes into being. Let us now discuss this culture in some more detail.

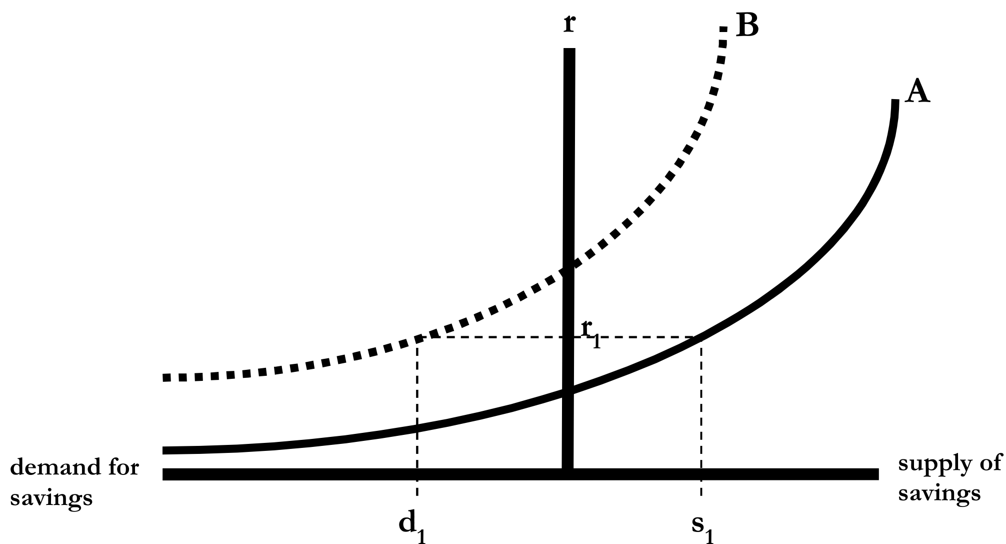
## *2. Short-Termism and Haste*

Paul has to hurry up with his credit purchase. He will not waste time, but instead see to it that he achieves as high an income as possible as quickly as possible. He will not study art history but business studies; he will not spend his university vacation on spiritual retreats but instead in internships; he will not read novels but instead subject literature; he won't fritter away his time in the park, but instead take a few weeks' compressed vacation and then throw himself back into working life. He's not looking for adventure or uncharted paths. His children wear him out and his spouse takes up a lot of his time. He doesn't want to hang around or fall behind his friends, who are acting very smart and going into as much debt as possible as soon as they can.

We have slightly exaggerated one particular sign of our times here, but in doing so have made it all the clearer: the tendency toward present-day orientation and short-termism

that permeates all areas of life. Thinking and acting are oriented toward short-term problems and goals of a material nature; long-term effects, especially if they are non-materialistic, tend to be neglected. There is less time for reflection and for conversation, less time for one's family, and of course less time for God.

In the technical jargon of our time, a permanently increasing (and therefore foreseeably increasing) price level tends to entail an increase of each person's time-preference schedule. In the figure below, this is illustrated by a leftward shift of the initial schedule A to a new schedule B. For any given inter-temporal exchange rate r, the person is likely to reduce the supply of his own savings, respectively to increase the demand for the savings of other people. In the below example, the person was initially a net-saver at the rate $r_1$, supplying savings of $s_1$ into the market; and then becomes a net-user of other people's savings, demanding the amount of $d_1$.




**<u>Figure</u>**

**Impact of Permanent Price-Inflation on Individual Time-Preference Schedules**

Based on Rothbard (1993 [1962]), Figure 43, p. 331

According to a commonly held view, this tendency is particularly pronounced in the business world. Greed entices the entrepreneurs to plan and invest for the short term and therefore to sacrifice the future on the altar of the present. In actual fact the exact opposite is the case. In companies – even in the oft-criticized banking sector – a lopsided and exaggerated orientation toward short-term goals is *relatively less* pronounced. Of course

there are such cases here as well. Companies are not immune to the general trend toward short-termism resulting from the fiat money system. However, they resist this trend better than families, associations and the government. This is so for two related reasons.

First, the core purpose of companies consists in acquiring money income. Therefore it does not as a rule escape their attention that short-term oriented company management leads in the medium and long term to competitive disadvantages and therefore to income losses. It is precisely their orientation toward money quantities and payment flows that preserves them from making the crassest mistakes.

Second, however – and this is the really crucial point – companies can be bought and sold. Unlike families, most associations and the government, they have a market price and *already now in the present* this price reflects the future development of the company as expected by potential buyers. Therefore an excessively short-term company policy will not just be felt in the future, but already in the present.

It is well known that things are different outside the business environment. The wrong choice of spouse is not immediately reflected in income and wealth. It is similar with a wrong distribution of chores within the family, the wrong use of leisure time, wrong parenting, the wrong choice of schools, wrong social interaction and so on. Of course, what makes a choice right or wrong in family life is not (or at most only partly) determined by whether income and wealth increase as a consequence. This is after all one of the most important differences between a family and a company. The crucial point is rather that companies have a clear error feedback mechanism, through which bad decisions become apparent fairly rapidly, even when the effects of these decisions will only unfold in the future. Families do not have anything like this. Of course even they are not completely without a compass. They receive good advice from friends and sometimes also admonishing words from parents and grandparents. But in an inflation culture it is quite unlikely that the right advice will be given. Those offering advice are ultimately part of this culture, and as a rule they will hardly criticize what is considered as normal.

### *3. Insatiability*

Capital accumulation within a natural monetary order will inevitably lead to lower returns on investment. This is true no matter what the form of investment. An increasing number of *loans* can only be granted at decreasing interest rates; an increasing number of *industrial investments* leads to decreasing profit margins. This in turn has very significant repercussions on the way in which savings are used.

If investment yields are already low, there is no great incentive to continue investing any additional savings. It is more likely that these savings will now be channelled in increasingly larger quantities into non-commercial uses. These include on the one hand the construction of private buildings and the financing of education for one's offspring, but on the other hand also altruistic uses in patronage of the arts and for charitable purposes, helping to pay for urban improvements and much more besides.

These tendencies prevailed in the western world in the 19th century and up until about the First World War. They changed under the inflationary fiat money systems of the 20th century. The incentive here is to protect all available savings from future price inflation by investing them in such a way as to maintain their value as far as possible, i.e. pre-eminently in real estate and securities. There is furthermore an incentive to take on as much debt as possible – i.e. to 'leverage' the profits arising from price inflation (detailed exposition in Hülsmann 2013, chap. 8).

However, this simply means that the natural saturation process of capital accumulation is overridden. *Even if* someone is already very rich, he can still hope to attain an attractive capital yield by investing his savings in real estate and securities. Moreover, *particularly when* he is already very rich, it is especially easy for him to go into debt and to invest the borrowed funds to further increase his wealth.

This is where the natural order of things is turned completely upside down. Increased affluence means increased excess income (savings). In a natural monetary order, the available savings would flow increasingly toward non-commercial uses. In the upside-down fiat-money world, on the other hand, there are strong incentives to invest preferably all available funds as capital – and not just one's own, but also borrowed funds. Instead of creating financial surpluses, which would increasingly be used outside the

market, wealthy people tend to absorb the financial surpluses of other people who either cannot or do not want to go into debt to the same degree.[6]

A direct and visible consequence is that it becomes increasingly difficult to raise private capital for non-commercial projects. The so-called 'social economy' shrinks. Here and there associations for urban improvements can still be found, and it is also unlikely that sports and cultural clubs will peter out completely. But the scarcity of capital is becoming noticeable everywhere, especially in the downright Spartan rooms of associations, in staff shortages and in the constant search for advertising income. It is not surprising that calls for government help in these areas are never-ending.

A more indirect and subliminal consequence is the disfigurement of human living space. One of the most depressing facts of western culture is the ubiquitous and downright pervasive tendency toward ugliness, which in the past thirty years has become virtually rampant. This trend is particularly noticeable in architecture, but also in clothing, literature, music and the visual arts. It may be difficult to substantiate aesthetic judgments in a way that is universally valid, but the economic mechanisms of aesthetic indifference are staring us in the face, and ultimately they stem from the printing press.

## *4. The Economics of Ugliness*

When savings increase in a natural monetary order, these savings tend to be used in ever greater quantities to finance non-commercial projects. In all these uses the greatest care is taken, right down to the smallest details. Buildings are constructed above all for the master builder himself. His personal taste is the crucial criterion here, and this taste is usually educated and refined. Future generations continue to draw the greatest benefit from it. For example, late 19th-century buildings from the time of the founding of the second German Empire are still very much sought after today.

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[6] This is *one* of the reasons why in the US – one of the richest countries in the world – there is a permanent balance of payments deficit. Another reason is that other countries have very much worse currencies, so that the citizens of those countries constantly import US dollars in order to protect themselves against the deterioration in value of the domestic currency.

Things are different under the influence of present-day fiat money systems. Here there are greater incentives to use all available savings commercially. Questions of taste on the other hand are of secondary importance. Buildings are now no longer constructed for the personal use of the master builder, but as capital investments. The master builder is therefore much less concerned with the aesthetics of his work than in a natural money order. If he considers questions of taste at all, he will not make decisions based on his *own* taste, but on the views of potential buyers, in other words of the average person. His intention is not to create an especially beautiful piece of work, but merely one that will not scare off potential buyers.

Therefore, even if it is difficult to establish what is ugly and what is beautiful in a way that can be generally valid, one thing is clear: from an aesthetic point of view, the inflation culture is pretty much a disaster. But it is worse than that: in most European countries a large proportion of newly constructed buildings are financed by *public or government contractors*, and this means that three further detrimental factors come into play.

First, the public officials concerned are only trustees of the public purse, i.e. they are neither positively nor negatively affected by the long-term effects of their decisions. Hence they have no particular interest in constructing solid buildings which they can bequeath to their children and grandchildren. Quite the reverse, in times of tight budgets there is an incentive for them to reduce spending. Politicians want above all to impress the *present* electorate. They therefore tend to push for the construction of as many homes as possible, which are of a standard that only just meets legal requirements.

Second, public decisions are usually made collectively or with participation from numerous interested parties. An agreement among so many people is usually possible only on the basis of the smallest common denominator – therefore tending to be even worse than the average taste. The results can be admired in so-called social housing projects around the world.

Yet frequently politicians, and above all public officials, do not want to make any decisions of their own. Especially in the case of projects that will have a large impact on the public, they dread taking responsibility for a failure. When this happens politicians generally pass the responsibility to experts of some description. If the voters are pleased

with the result, the politicians can pride themselves on having hired the right people. If something goes wrong, then they have at least shown due diligence and can pass the buck to the experts. But who are these experts? In the field of architecture we can distinguish two groups.

The first group are academics and artists in public service. These are people who in a free market could typically only earn a fraction of the income which the government offers them. The reason is that hardly anyone likes their products. They of course believe that the only reason for this is the lack of education on the part of the masses. What is necessary in their view is to educate these ignoramuses by constantly placing as many buildings of professor X and as many sculptures of professor Y in front of their eyes. After the Second World War large hordes of such charlatans with a sense of mission were commissioned to plan and design the public space. We all know the results.

The second group are famous freelance architects and engineers. These people have to be *famous*, otherwise it wouldn't be possible to 'sell' them as experts to the politicians and voters. Nowadays these celebrities are passed around from country to country and in some cases around the entire globe. The result is the unification and standardization of the architectural landscape. But of course only very few people are really famous, so there is still a huge number of the first group.

These changes are scarcely noticeable when an intangible fiat currency is first introduced, because they are neutralized or overcompensated for by numerous other factors. To begin with, family traditions, education and the generally prevailing views are still very much shaped by the previous, more natural monetary systems. Only gradually do the previously discussed economic forces become noticeable. In the end however these forces lead to a general change in behaviour. There is a reassessment of all values, beginning in the previously mentioned areas that are more or less directly affected by the inflationary money system. Eventually the new habits arising here are mirrored in other spheres of life, which are not at all – or at least not directly – affected by the change in choice of how savings are used.

## *5. Soap Operas and Rationality Traps*

Bubble markets are often and very appropriately compared to soap bubbles. Soap bubbles are large but hollow. Their very being is external and superficial. Thus they are fragile and have to be protected from colliding with hard objects. Even without such collisions, at some point in time they burst because their skin vanishes at the mere touch of air and light. The space they occupied just before is then indeed still filled with its gaseous substance, but the illusion disappears. Only after the bubble has burst do form and content once more coincide.

The soap opera is a typical product of inflation culture. It too is all illusion and superficiality. It does not educate or offer any orientation. It offers no wider horizons. It opens up no new perspectives. It reflects the microcosm of a shallow soul with its petty fears, small hopes, and miniscule problems. True tragedy is replaced by melodrama, so as to become comprehensible and agreeable.

Most of what has been presented to the European populace in the last few years as big government politics actually belongs to the genre of the soap opera. The continually unsuccessful attempts by European heads of government to get the banking and sovereign crises under control raised the suspicion that Groucho Marx had tried to stage a Greek tragedy, say under the title: 'The bailout of the bailout of banks and governments'.

In the first act an elderly Ulysses appears, imploring the mean Hagen von Tronje to help him. In the second act Ulysses is joined by Don Quichotte and his Celtic extras from Portugal and Ireland, who all have something to answer for and who also want to hole up with Hagen. In the third act curtain up for La Traviata, a faded beauty who has been abandoned by her lovers. She remembers her old friend Hagen and all at once sings the great aria in praise of his virtue. Still behind stage lurks Cyrano de Bergerac who gives Hagen a couple of hefty slaps in the face every time there's an intermission. This keeps the adrenalin up at the necessary level for the gruesome end of the sleazy soap opera that is eagerly anticipated by everyone. Whenever the actors and their audience get tired, the shrill song of the pan-European dwarf choir pipes up: 'Bailout the bailout! Bailout the bailout! Show solidarity!'

The soap opera has a legitimate place in human life, but in an inflation culture such as ours it becomes dominant. This is because it meets an audience that demands easy nourishment for the mind: nourishment that can be immediately digested and that requires as little effort as possible on their part. Inflation culture promotes present consumption and discourages saving and investment. It sacrifices future material and intellectual wealth on the altar of present indulgence.

The premeditated inflation of the money supply for the immediate benefit of governments, banks, and other financial intermediaries creates strong incentives for these beneficiaries to reduce their (costly) efforts of self-protection. Governments have piled up towering debts, clearly believing that a repayment of these quantities is out of the question in any case. Banks and most other financial companies have long since reduced their equity base and liquidity to a rather symbolic minimum.

This process is very old. It came into full swing in the second half of the 19th century and its excesses were readily observable already at that time. A hundred and forty years ago the German economist Carl Knies wrote the following lines commenting on the follies of the 1870-73 *Gründerzeit* boom years. It is as if he had written them for our day:

> "Suddenly one is exposed to the demonic rule of insuperable accidents, which one had once learnt to perceive as a characteristic feature of 'barbaric' economic conditions. Property and commerce become uncertain, even though the police and the courts continue their work as usual. Efforts made along time-tested paths, intense work in the pursuit of well-known objectives are paralyzed, and the floodgates are widely opened to the "adventurers." Even the profits that result from prescient calculation are acquired only at the expense of others. No-one is grateful to the government for his undeserved profit, and everybody indicts it for his undeserved losses. Was it not one of the government's most important missions to vouch for the soundness of money? But how often has this already been said! How much to the point, how congruently have the consequences of depreciated paper money been perceived!" (Knies 1873, p. 282)

Governments and banks have always assumed that the costs of their actions would ultimately be covered by others. Economists call this perverse incentive to misconduct at

other people's expense 'moral hazard', meaning the temptation to get rich by immoral means. Of course a common thief also wants to get rich at the expense of his victim, but he runs the risk in doing so of being caught and punished. It is completely different when the government removes this danger and even holds out the prospect of a reward for particularly avid enrichment at the expense of others. Then the above-mentioned temptation is virtually institutionalized, and irresponsibility ensues on a massive scale.

Since monetary interventions make some known activities gain at the expense of others, it is natural that the market participants try to join the ranks of the winners and avoid those of the losers. They can do this by opportunistically choosing activities that place them within reach of central-bank assistance or, in other words, among the early users of the newly created money units. There will then be more higher-ranked civil servants, bankers, and financial advisers; and there will be fewer carpenters, bakers, gardeners, engineers, and tailors.

If the opportunists are few, then it is possible for these few to increase their revenues, not only in comparison to what they would have gained in other trades, but also in comparison to what they would have gained if the monetary intervention had not taken place. By contrast, if many persons follow the opportunist path, the gains become diluted. Eventually, the revenues of civil servants, bankers, and financial advisers (to name just these few) would only be marginally higher than the revenues that the same persons could earn elsewhere, and thus their behaviour becomes farcical and absurd. For though they would still gain higher *monetary* revenues than in other trades, their *real* revenue would decline, relative to what it would have been in the absence of the intervention. It would decline, along with the real revenues of everyone else, because after all there are now fewer carpenters, bakers, gardeners, engineers, and tailors to provide them and all others with goods to exchange for money.

In the case of a small inflation this problem might barely be visible. Aggregate material output always declines as a consequence of the intervention-induced reorganisation of the division of labour. But it might just decline *relatively to what it would have been in the absence of the intervention*, not *relative to what it was before*. By contrast, large inflations create monetary revenues that attract not just a few more civil servants, bankers, and financial advisers, but

entire armies of them. At some point, then, aggregate material output is likely to diminish not just in relative, but in absolute terms: not just a slow-down, but impoverishment.[7]

The odd thing is that most people involved are basically aware that everyone is currently in the process of sacrificing their future. But they suppress this insight and don't feel responsible. What they are ultimately waiting for is a miracle. They believe that due to currently still unknown circumstances only other people will be affected by the negative consequences of what is going on all around them, while they themselves will be spared.

In the jargon of today's economists such problems are called rationality traps or prisoners' dilemmas. Government interventionism encourages people to behave in a way which from the individual's point of view is entirely rational but which, due to the fact that everyone else is behaving the same way, becomes absurd. Hans-Hermann Hoppe (2001, 2012) has repeatedly and very emphatically pointed out that these tendencies are literally rooted in the very nature of the modern (interventionist) state. The economic core of the modern concept of the state is a deal with the devil, in which the citizens pledge to give up their right to protect themselves, and to allow the government to have a monopoly on the judicature. Here the basic pattern of irresponsibility is laid out. The 19th century French economist Frédéric Bastiat had recognized this when he very aptly defined the state as the 'the great fictitious entity by which everyone seeks to live at the expense of everyone else.' Individual people are behaving in a totally rational way but society as a whole is going downhill.

## *6. Willing Dependence and Politicisation of Society*

Nowadays the average citizen spends the greater part of his life servicing loans, which in most cases there would have been no occasion for without the fiat money system, and

[7] The problem is not limited to the financial sector. It runs like a common thread through all those areas of life in which government coercion has created the option of enrichment at others' expense. Single parents are subsidized, so the incentive to marry is reduced and we have more and more single parents. Juvenile delinquents receive either mild or no punishment at all, therefore more and more children and youths enrich themselves (respectively the adults who abuse them) through violent attacks on their fellow human beings. The unemployed are supported by coerced money, so the incentive for unemployment increases as soon as the market rates for wages fall to the level of government payments. Real estate is subject to government restrictions and can be expropriated if required, with the consequence that the ground is over-fertilized and overused. Government pension schemes undermine incentives to marry and start a family. Government health provision encourages nicotine and alcohol consumption, overeating, excessive sport activity, lengthy stays at health spas and so on. The public education system increases incentives to study for as long as possible and with as few challenges as possible; but there is no overall economic demand for an army of social workers, English studies and MBA graduates.

which he therefore would not have taken up. The result is that the population has been transformed into a bunch of willing part-time servants of the banking industry and the government.[8]

Of course it is not the banker or the insurance broker who forces Paul to go into debt. Force is applied at a subliminal level, which evades insight and the direct exertion of influence by almost everyone, i.e. at the monetary system level. This is where the government forces its citizens to use a kind of money that is particularly easy to increase in quantity. Debt economy and inflation culture then emerge due to this coercion.

If the government were to ban all brand X vehicles and only brand Y vehicles could be traded, then all purchases and sales would still take place by mutual agreement or on a voluntary basis. But it is obvious that the citizens' freedom of choice would be artificially limited; and that they would thus tend to purchase greater quantities from company Y, and into the bargain pay higher prices than would otherwise have been the case. It is precisely to this extent that the citizens have become part-time serfs of company Y, even if this company has neither instigated nor sought or endorsed the government ban on the competitor's products.

To all outward appearances freedom of contract prevails, but in actual fact this freedom is only limited. In many cases the citizens are fully conscious of this, but where money is concerned such an awareness is usually lacking. The worst sort of tyranny is the one which makes us forget the difference between freedom and serfdom.[9] The citizens are *willing* part-time serfs, because from a microeconomic perspective their conduct makes good sense. In a manner of speaking the fiat money system hands carrots to the government and the banks, which they hold under the citizens' noses, and which almost everyone chases after – due to poverty, greed or understandable self-interest.

For the same reason the citizens also develop a self-interest in maintaining this system. They virtually demand that all be done to maintain the smooth running of the credit markets. How else are they supposed to finance a home purchase? How else are they supposed to set up a company or finance the planned company expansion? One can

[8] They are in any case serfs of the government, whom they pay tribute to all their lives, especially in a democracy. See Hoppe (2012); F. Karsten & K. Beckman (2012).

[9] Similarly we read in Johann Wolfgang von Goethe's *Wahlverwandtschaften* [*Elective Affinities*]: 'No one is a slave more than he who, without being free, considers himself so.' (2nd part, chapter 5)

explain to people, like Paul in our example above, that the easy availability of loans does not lead to an improvement in the *macroeconomic* situation. From their personal point of view, however, this is certainly not a compelling reason to change the system. As soon as somebody becomes a debtor, he has a material interest in creeping inflation continuing its accustomed way. So if he doesn't have too many scruples, he will indeed support institutions that generate this price inflation, even if he sees them as useless, or worse, harmful to the common good. Thorsten Polleit recently very aptly described this phenomenon as 'collective corruption'. He wrote:

> Not just a few, but a growing number of community members and whole groups of society have become unconditional supporters of government coercive measures. Consequently the considered self-interest of the individual serves policies through which society is being visibly transformed into a collective socialist community: a government that is growing increasingly stronger and a mania for rules and regulations at the expense of individual freedom. Collective corruption sets the course toward higher inflation or even hyperinflation. Because given the choice of accepting the collapse of governments and banks and therefore a recession or depression, or printing new money, in the course of a pronounced collective corruption a majority will be found which will lobby against a wave of bankruptcies and in favour of printing money.[10]

The *beneficiaries* of the fiat money system include not only financial industry companies, government officials and receivers of subsidies, but ultimately all companies which are dependent on loans, and all households which have built their dreams of an early purchase of a home and the rest of their life plan on the easy availability of loans. The *supporters* of the fiat money system include not only current debtors, but also those who are planning to take up loans in the near future, in order to be for a short time on the winning side of inflation.

[10] Thorsten Polleit (2012); see also Polleit (2011). The author underscores that most conventional economic theories have not taken this phenomenon into account. These theories are based on the assumption that policies which damage society can only come about due to lobbying work by small but powerful minorities. An important example is Olson (1982)

If nothing else it is in this way that the citizens' interests are brought into line with the government's interests. That is arguably the greatest political trick in world history. There is normally some conflict between the interests of the rulers and the interests of the ruled. All the resources claimed by the rulers must ultimately be wrested from the ruled, and tax collection is very costly. It necessitates the upkeep of whole armies of soldiers, police officers, tax authorities and so on. The more extensive the resources claimed by the rulers, the greater the collection costs, and these costs increase disproportionately to the tax revenues.

This problem can be elegantly circumvented with a fiat money system. A fiat money system transforms the population into the money lords' happy customers. Of their own free will they hand over their savings to banks, insurance companies and investment funds, and the government now has an easy job. Instead of wangling the more or less limited amounts of individual savings from a large number of people – as already mentioned, a very costly undertaking – it now only needs to concern itself with the relatively few intermediaries. This is inexpensively done, e.g. by appropriate statutory regulations which compel the banks and insurance companies to invest a certain proportion of the savings managed by them in government bonds. Resistance need not be feared from this quarter, or it can be simply and inexpensively nipped in the bud. If a bank no longer wants to lend the government any more money, the government can, if necessary, threaten to discontinue its banking licence.

The inflation culture strengthens the power of government also in another way, namely by increasing the demand for government intervention in the economy. In a debt economy each individual can be affected by the mistakes of everyone else, and in principle overnight. The more widespread the practice of getting into debt, the more fragile the economy tends to be from an overall point of view, and the more every individual is affected by the mistakes of his fellow human beings. People with whom we never had, and never will have, anything to do personally, threaten our material well-being by their possible misconduct. From this follows quite automatically a heightened interest in the business conduct of others, and the desire to influence by political means the business conduct of above all the larger – 'too big to fail' – market participants.

On the one hand, one will of course want to put a stop to improper business practices like fraud and embezzlement. On the other hand, however, one will also want to make provision for the possible mistakes of the other market participants, by using government regulation to force them to cultivate certain other practices that they might not have chosen of their own accord.[11]

A growing debt economy therefore tends to lead to a growing politicization of economic and social life, to increasing restrictions of freedom of choice for individuals, families, associations and companies, with the justification that only in this way is it possible for the whole system to survive financially. At present the most affected are the large financial sector companies, and in the course of the European sovereign debt crisis even nation states are now to be kept on a tight EU-rein by Brussels. But the very logic of the unfolding of the debt economy means that increasingly medium-sized – and eventually even small and micro – units will be affected. The 'too big to fail' size is not a natural constant (see Hülsmann 2013).

In order to maintain and promote the system as a whole, every company and household will eventually be told how and when they are to spend or invest their money right down to the last detail. It will always be possible to justify even the most draconian measures by saying that deviant behaviour threatens the functioning of the overall system. Today this pattern of argumentation is already clearly evident in other government "systems", especially in the health insurance system.

* * *

Somewhere along the way to a totalitarian state, democracy dies. This casualty is also more or less directly linked to the money system. Easier government financing, made possible by the printing press, undermines the foundation of democratic politics. Because government bodies are now supported directly or indirectly by the printing press, they no longer have to rely on getting the necessary popular support for their policies. They are no longer forced to have raised spending through increased taxes approved, but can carry out their projects by financing them with larger loans or even directly by printing money.

[11] Of course there are also other motivations for the regulation mania of modern-day governments.

No-one has addressed this more clearly than Ludwig von Mises (1953, p. 224): "When governments do not think it necessary to accommodate their expenditure to their revenue and arrogate to themselves the right of making up the deficit by issuing notes, their ideology is merely a disguised absolutism."

Without the hidden 'inflation tax' governments would have to make do with those resources which accrue to them as taxes and similar compulsory charges. The extent of their activities would therefore always be limited in financial terms by popular consent. Increasing government debt would also be unthinkable, because governments simply wouldn't have the funds to service it. But the ability to produce intangible money – in quantities that are in principle unlimited – changes the circumstances. Governments can now make funds available at the expense of the rest of the economy at any time without being dependent on popular consent. This can be achieved either by the central banks providing the governments directly by printing money (the exception), or by them funding the financial markets and thereby enabling additional loans to be made to the governments (the rule). In either case the governments thereby escape direct financial control by the people, and this also changes the relationship between citizen and government. The latter is less and less the agent of the citizens, but instead sets itself up as their ruler. Its activities take up an overly large position in economic, societal and cultural life – and this happens, as we've already said, at the expense of the population's activities, since the total quantity of resources is limited.

## ***Conclusion***

In our present contribution we have explored some of the cultural consequences of a permanent expansion of the money supply. We have focused on the specific case of credit expansion (*ex nihilo* creation of money through credit) which has held centre stage of the monetary evolution of the past two hundred years and, even more specifically, on credit expansion pushed to such an extent that it entails permanent price-inflation. We have argued that the debt economy promotes short-termism and haste, insatiability, ugliness especially in architecture, and rationality traps. It also creates strong tendencies for willing political dependence and for a politicisation of society.

These observations merely scratch the surface of our subject. The main purpose of the present contribution is to suggest to other researchers that the subject is worthy of more systematic attention.

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