Etica & Politica / Ethics & Politics, 2003, 2
http://www.units.it/etica/2003_2/HOPPE.htm

Government, Money, and International Politics

Hans-Hermann Hoppe

Department of Economics
University of Nevada

ABSTRACT

In this paper, the author deals with: (1) Definition of government; incentive structure under government: taxation, war and territorial expansion. (2) Origin of money; government and money; the devolution of money from commodity to fiat money. (3) International politics and monetary regimes; monetary imperialism and the drive toward a one-world central bank and fiat currency.

1. Government defined

Let me begin with the definition of government: A government is a compulsory territorial monopolist of ultimate decision-making (jurisdiction) and, implied in this, a compulsory territorial monopolist of taxation. That is, a government is the ultimate arbiter, for the inhabitants of a given territory, regarding what is just and what is not, and it can determine unilaterally, i.e., without requiring the consent of those seeking justice or arbitration, the price that justice-seekers must pay to the government for providing this service. (1) Except for some so-called public choice economists such as James Buchanan, it is obvious that such an extraordinary institution cannot arise "naturally", as the outcome of voluntary contractual agreements among individual property owners. (2) For no one would agree to a deal that entitled someone else, once and for all, to determine whether or not one was *truly* the owner of one's own property, and no one would agree to a deal that entitled this monopoly judge with the power to impose taxes on oneself. Rather, an institution such as government would normally, and from the outset, be regarded as an illegitimate and indeed criminal protection racket. And as a protection racket, this institution would tend to be brought down quickly. It is only possible for such an institution to survive for any length of time if and insofar as it succeeds in instilling in the "protected" public a myth, i.e., a false yet generally held, and hence effective, belief. In order to make the public accept, i.e., not to resist, the protection racket, it must be persuaded that without a monopoly of jurisdiction and taxation (that is, in what has been called a "state of nature") constant warfare among individual property owners would exist. I have called this belief the Hobbesian myth and identified it as the most powerful and widespread myth of the modern world. (3)

It is not my intention here to further analyze this myth. Rather, I want to analyze and develop the consequences that follow from the fact that this view is actually believed, and hence, that a protection racket is regarded as legitimate - as a government rather than a protection racket. First, if government is generally held to be necessary for the establishment of internal peace, it follows that its agents will take advantage of their monopoly: they will increase taxes and reinterpret the law to their own advantage. The price of justice will rise and its quality will fall. In other words, government does indeed have an interest in making peace among its subjects, i.e., in preventing one subject from warring against and/or robbing another one, but only in order to rob all of its subjects more successfully itself.

However, instead of concentrating on the internal consequences of government, I want to concentrate my attention on the external consequences, i.e., on its foreign rather than domestic policy. In this regard, two observations are of fundamental importance. On the one hand, by virtue of its power to define and interpret the law and to tax, every government is faced with the risk of exit. Its subjects might leave the territory over which the government's authority extends in order to avoid taxation and its perversions of law. And every such exit implies a loss of potential revenue to the government, whereas any population increase promises potentially higher tax revenues.

On the other hand, at least at the outset many competing governments exist, each not only faced with the threat of exit but also equipped with the power to tax, i.e., to externalize the cost of territorial expansion (foreign aggression) onto its own subject population. Hence, it can be predicted that competing states will come into conflict with one another. The competition between governments is different, however, than the competition of private firms. In any given territory, only one monopolist of jurisdiction and taxation can exist. Hence, the competition between governments will tend to be violent, resulting in interstate wars, and eliminative. By means of war, one state expands its territory at the expense of another, and the number of remaining states will progressively fall. A tendency toward political centralization is set in motion which comes to a halt only once a single world government has been established and the threat of exit is thus eliminated. (4)

We can be even more specific regarding the tendency toward political concentration in questioning which states will tend to be victorious in interstate warfare. Victory or defeat depends on many factors, of course, but in the long run, the decisive factor is the relative amount of economic resources at a government's disposal. In taxing and regulating, governments do not contribute to the creation of economic wealth. Instead, they parasitically draw on existing wealth. However, governments can influence the amount of existing wealth negatively. Other things being equal, the lower the tax and regulation burden imposed by a government on its domestic economy, the larger its population will tend to grow (on account of internal reasons as well as immigration factors), and the larger the amount of domestically produced wealth will be on which it can draw in its conflicts with neighboring competitors. That is, states which tax and regulate their domestic economies comparatively little - liberal states - tend to defeat and expand their territories at the expense of less-liberal ones. This explains, for instance, why during the nineteenth century Britain became the dominant imperial power, and why in the twentieth century this role has fallen to the U.S.

Even more specifically, it explains why the United States, internally one of the most liberal states, has conducted the most aggressive foreign policy, while the Soviet Union, for instance, with its entirely illiberal (repressive) domestic policies has engaged in a comparatively peaceful and cautious foreign policy. The US knew that it could militarily beat any other state; hence, it has been aggressive. In contrast, the Soviet Union knew that it was bound to lose a military confrontation with any state of substantial size unless it could win within a few days or weeks. (5)

2. Government and money

Now let me turn to the next question: the relationship of government and money. Here it is hardly necessary to explain in great detail that money is the natural outgrowth of a market economy. Due to the existence of uncertainty, in barter fundamental obstacles to trade exist. Double coincidents of wants are not always present; hence, direct trade becomes impossible. As a way out of this predicament, man begins to look for especially marketable goods, and trades whatever he has to sell for more marketable goods in order to be able to then turn around and acquire with these those things that he really wants. That is, man begins to demand things to be used neither as consumer nor producer goods, but as a facilitator (medium) of exchange. Others copy this practice, and sooner or later most people in society use the same good for the same purpose. Money, a commonly used medium of exchange emerges. And as trade becomes world-wide, a tendency toward the use of a single world-wide medium of exchange comes into existence. Historically, this was the international gold standard. (6)

Money, then, comes into existence as a commodity money. In fact, money is the most easily saleable commodity. It is produced by the market, like any other good. There is competition in gold mining and gold minting; and in addition to genuine money, there are money substitutes, i.e., titles (notes) to money. This, then, is the situation with which governments find themselves confronted: a commodity money such as gold, produced by profit-driven money producers and entirely outside of the government's control.

Now recall the definition of government as a monopolist of jurisdiction and taxation, and assume no more than self-interest for government agents, i.e., that they as everyone else prefer more over less income. What will be the government's position *vis-à-vis* a market provided money? As should be immediately clear, it will try to gain monopolistic control over the supply of money, so as to be able to enrich itself at the expense of its subjects (very much as it enriches itself at the expense of its subjects by means of taxation). (7)

In order to reach this goal, a government must take three consecutive steps. Indeed, all governments have taken these steps. Some have done it earlier and others later, but all of them have done so in the same order. First, a government monopolizes the minting of gold. No one but the government mint is permitted to produce gold coins. With this step it becomes possible for the government to engage in coinclipping, i.e., surreptitiously reducing the gold content of coins. In recalling and reminting gold coins, and reducing, for example, the gold content of a coin by 10 percent and increasing the supply of coins by 10 percent, the government essentially accomplishes the same thing as raising the tax revenue by 10 percent, except, of course, that it is more difficult to understand the causes and consequences of inflation than it is to understand the causes and consequences of higher taxes. However, this first step is still highly unsatisfactory from the point of view of government, because it cannot engage in this practice repeatedly without some people eventually realizing what is going on.

In the second step, the government monopolizes the production of money substitutes, i.e., of paper titles to gold-property. No one except the government bank can issue banknotes redeemable at par into genuine money. The commercial banks may only produce checkbook-money (substitutes of money-substitutes). That is, paper that is convertible at par into government produced paper, which in turn can be converted into genuine money (gold). With this step it becomes possible for a government to engage in fractional reserve banking practices. The government bank creates additional money substitutes out of thin air, uncovered by genuine money. Or put differently, it creates more titles to money property than there is money property in existence. (8) By bringing these titles into circulation it enriches itself at the expense of the general public. Again: an increase of money substitutes, created practically at zero cost, of say 10 percent beyond gold coverage has the same effect as a 10 percent tax increase; but taking the course and form of inflation, it is more difficult to detect than the tax increase. However, even this second step is unsatisfactory from the point of view of government because eventually the public will realize what is going on. And once it does, runs on the central bank will occur. The holders of titles to money will want to have their titles redeemed into the genuine thing. But since there exist more titles (notes) than property (gold), the central bank, faced with a run, will either go bankrupt or suspend specie payment.

In the third step the government goes off the gold standard. The gold deposited in government vaults is confiscated and the private ownership of gold is outlawed. Having acquired purchasing power as something else - and *more* - than mere pieces of paper, namely as *titles* to a money commodity (property), the former money substitutes become money. A pure fiat money currency takes the place of the former commodity money standard. Finally, or so it seems, the government has reached complete counterfeiting autonomy and can print money, out of thin air, and acquire real goods with this paper. The only task remaining seems to be that of avoiding hyperinflation.

In fact, other problems and obstacles remain in place even then. Before addressing them, however, a few remarks must be made concerning the question of how the government can get away with taking the three steps just outlined. It can only do so if it succeeds in creating a favorable public opinion. In order to do so it will have to promote a few myths, i.e., make the public believe a few erroneous but somehow plausible propositions: First, that competition in money production will lead to fraud by profit-driven capitalists (even though competition is in fact precisely the means of reducing the likelihood of fraud, and fraud will actually be more likely if money is produced by a monopolist). Second, that a commodity money involves substantial resource costs which could be saved and the resources productively invested if one had a paper money standard in place (while, in fact, as even such an ardent fan of paper money as Milton Friedman admitted late in his life, a paper money standard and the increased financial uncertainty brought about by it increases the expenditures - and the waste of resources - in activities such as hedging, financial newsletters, etc., and has actually driven up the price of demonetized gold, and hence the volume of gold production). (9) And third, that money is part of social wealth such that more money means greater wealth (while, in fact, money is *not* part of social wealth and a larger amount of money only leads to a falling purchasing power of money, while more money leads to a redistribution of the existing wealth in society and benefits the early receivers and spenders of this money at the expense of those receiving and spending it later).

3. Monetary Imperialism

Now back to the obstacles that still remain in the path of governments wanting to achieve total counterfeiting autonomy. They become obvious once we introduce the existence of more than one government into the picture. Let us first assume that these competing governments are of roughly equal strength as regards their military power only to return then to the beginning, i.e., the tendency toward political centralization, imperialism, and ultimately world government. (10)

Let us take the example of two countries, France and Italy, and briefly analyze the situation first for stage two in the process of the destruction of the gold standard and then for stage three. In stage two, both France and Italy have monopolized the minting as well as the production of money substitutes. If the French government now, based on its monopoly in the production of money substitutes (titles to gold), increases the production of paper Francs beyond the increase of paper Liras, prices in France will increase relative to prices in Italy. Consequently, exports from France to Italy will fall, and imports into France from Italy increase. In order to pay for this increasing volume of imports, gold will flow out of France and into Italy. Consequently, the ratio of gold reserves to paper-Francs will fall, increasing the likelihood of a run on the French central bank. France must now reduce the supply of paper Francs, and the forementioned imbalance will be reversed. Thus, as much as each individual government would like to inflate, this inclination is constrained by the existence of other governments and their currency. (11)

The situation is similar in stage three with pure paper currencies in existence and gold out of the picture. If France now inflates faster than Italy, again exports from France will decline and imports into France increase. But instead of an outflow of gold from France to Italy, now the French Franc will depreciate relative to the Italian Lira, and the trade imbalance will be reversed in this way. Again, the tendency of each individual government to engage in inflation is curtailed by the existence of other governments and the fluctuations in the currency markets.

Returning to my initial remarks, it is necessary to recognize how the remaining obstacles to counterfeiting autonomy are to be overcome. Let us consider a world in which the process of political concentration has been effective for some time. As the result of interstate wars, large and mighty superpowers exist such as the U.S. and smaller, militarily defeated and dominated countries such as Germany. In contrast to the situation between two "equal" countries, France and Italy, monetary relations between the U.S. and Germany are significantly different and reflect this power difference. (12)

In this case too we can distinguish between two stages of development. Exemplary of the first one is the system that was established at Bretton Woods. The U.S. is off the gold standard domestically, but it assumes the responsibility of redeeming paper dollars into gold (at fixed parity) *vis-à-vis* the German central bank, while the German central bank promises to exchange paper marks into paper dollars (at fixed parity). It would seem that Germany is still on the gold standard, for marks can be redeemed into dollars and dollars into gold. *De facto*, however, matters are completely different. The German central bank is pressured not to make use of its right to redeem dollar notes into gold but to use its dollars instead as reserves on top of which it creates mark notes. I will explain what is now in existence in the starkest possible terms in order to make the situation as clear as possible. Now let's say the U.S. central bank creates $50,000 out of thin air and uses this money to buy DM 150,000 (assuming an exchange rate of 1:3) from the German central bank and then turns around and buys, let's say, a Mercedes for this price. What does the German bank do with its $50,000? Does it buy something in the U.S. or insist on redeeming this sum into gold? The answer is of course, No. Rather, the $50,000 are registered as an increase in the bank's dollar reserves, and given this increase, the German bank then creates an additional DM 150,000 out of thin air, and turns around and buys itself a new Mercedes, too.

Obviously, the U.S. now has a trade deficit with Germany: imports exceed exports. However, this is a "deficit without tears" (13) because no payment (exports) is being made for the imported Mercedes, and the dollar does not fall against the mark. Instead, a system of two-fold exploitation is imposed on the German public. First, it gets ripped off by the U.S. central bank, then, facilitated by the first rip-off, it gets ripped off once more by its own central bank. We can call this system monetary imperialism.

But this first stage of monetary imperialism is still imperfect from the point of view of the dominant country, the U.S. There may still exist other countries, not yet fully controlled by the U.S., let's say France under someone like de Gaulle, fancying himself to be the president of a mighty military power in its own right. In this case, the German central bank might be tempted to sell its dollars to the French bank in exchange for Francs, and the French central bank in turn might be audacious enough to approach the U.S. with a request for redemption into gold. But, of course the U.S. does not have the gold or has insufficient amounts of it. The bluff has been called, and the U.S. is faced with a bank run. What should be done? The answer depends on the relative strength of the parties involved. In fact, as we know, given the superpower status of the U.S. and the insignificant status of France, de Gaulle's aspirations notwithstanding, the U.S. simply suspended specie payment, France essentially did nothing but to accept the fait accompli, and the world entered stage two of U.S.-managed monetary imperialism.

The second stage is like stage one except that gold no longer plays a role. All countries are on a pure fiat money standard. The U.S. initiates the process of inflation, and by using dollars as reserve currency, U.S. inflation is exported to U.S.-dominated countries, while goods flow into the U.S. in the same way as described before. Yet a run on the U.S. gold reserves is no longer possible, of course. Even this system is unsatisfactory, however. In a world of many countries, and even if the U.S. is a superpower with troops stationed in well over 100 countries around the globe, this system of coordinated inflation is bound to crack again and again. On the one hand, a

U.S.-dominated country might suffer more inflation than the U.S., its currency would depreciate against the dollar, and in order to save government-connected investors in those countries, the U.S. might be compelled to engage in expensive bailout operations, i.e., buying up the falling currency in order to stabilize it. On the other hand (and this is potentially even more dangerous), a U.S.-dominated country may inflate less than the U.S., its currency would appreciate against the dollar, and, if this became a trend, the dollar would lose trust and might be abandoned in favor of the other, harder currency.

As the final solution in the drive toward monetary imperialism and as a decisive intermediate step in the drive toward world government, the U.S. has been working long and hard to establish a U.S.-controlled world central bank issuing a single, world-wide accepted paper currency. (14) Only then are all obstacles to government counterfeiting eliminated because then the currency can no longer rise or fall against any other as no other currencies are left. The monetary integration currently under way in Europe, the establishment of a Europe-wide EURO, is an important step in this direction. The EURO will be more inflationary than the least inflationary of the previously existing national European currencies, the German mark. And it is easier for the U.S. central bank to "cooperate" with a single European central bank than with some fifteen or so different banks. Moreover, whereas these fifteen odd banks also could (and in fact did) use other reserve currencies besides the dollar, namely those of other European currencies (notably the German mark), with these other currencies gone, what else but the dollar can the European bank use for this purpose?

Do not forget, however, that success in this attempt to establish a world central bank requires public support, and to secure this support it is necessary to promote another myth. Indeed, the same myth that is propagated currently in Europe to establish the EURO. This is the myth that a single currency reduces transaction costs. There will be no more tedious exchanging of money when you travel from Germany to Italy, for example. This myth contains an important half-truth - and this makes it particular dangerous and potentially effective, because it is indeed true that money more truly serves its purpose as a medium of exchange the more widely it is used. International trade and economic calculation is in fact facilitated by the existence of a single money. Commodity money such as gold, which emerges as the result of markets and market exchange, has the tendency to become a world-wide used commodity money as trade expands. (15)

Matters are fundamentally different, however, if this money is a fiat money produced by a government world central bank. Given the nature of government, we can safely predict that such a money will be more inflationary and lead to a more massive redistribution of income and wealth in favor of government and its favorite supporter-clients at the expense of the general public than anything seen so far. Indeed, if we are to have a fiat money (rather than a commodity money), and the only alternative is to have competing national paper currencies or an international paper money, the choice is clear: As much as competing and fluctuating paper currencies are dysfunctional as facilitators of exchange, the former alternative is infinitely better.

4. *Conclusions*

The course of human history is ultimately determined by ideas, whether they be true or false. There is no natural law that causes government, interstate war, imperialism, and finally world government. Nor is there a natural law stating that a market-provided commodity money such as gold will be destroyed eventually and replaced by government produced fiat (paper) money. These events and tendencies only occur and prevail if and as long as a majority of the public holds certain beliefs. (16) In particular, the public must believe in the above mentioned Hobbesian myth and the myth that money constitutes part of social wealth (such that more money implies more wealth). Once the public has grasped that government is a protection racket and a warmonger (rather than a protector and peacemaker), and that a central bank and government paper money are simply the government's Department of Money-Counterfeiting and the instruments for continual redistribution of income and wealth in favor of the government and its friends, not only will we be spared the nightmare of world government and world paper money but we may actually see the restoration of the gold standard and the withering away of the state as a moral and economic perversity.

Notes

(1) See further on this Murray N. Rothbard, *The Ethics of Liberty* (New York: New York University Press, 1998).
(2) For the contrary view see James Buchanan & Gordon Tullock, *The Calculus of Consent* (Ann Arbor: University of Michigan Press, 1962), p. 19; for a critique of this view see Murray N. Rothbard, "Buchanan and Tullock's *Calculus of Consent*" and "The Myth of Neutral Taxation", both in: Rothbard, *The Logic of Action*, Vol. 2 (Aldershot, UK: Edward Elgar, 1997); Hans-Hermann Hoppe, "Fallacies of the Public Goods Theory and the Production of Security", *Journal of Libertarian Studies*, Vol. 9, no.1, 1989.
(3) See Hans-Hermann Hoppe, "The Private Production of Defense", *Journal of Libertarian Studies*, Vol. 14, no. 1, 1999.
(4) See further Hans-Hermann Hoppe, "Marxist and Austrian Class Analysis", *Journal of Libertarian Studies*, Vol. 9, no. 2, 1990.

(5) See further Hans-Hermann Hoppe, "Small is Beautiful and Efficient: The Case for Secession", *Telos*, No. 107, Spring 1996.

(6) See further Carl Menger, *Principles of Economics* (New York: New York University Press, 1976); Ludwig von Mises, *The Theory of Money and Credit* (Indianapolis: Liberty Fund, 1980).

(7) See further Murray N. Rothbard, *What Has Government Done to Our Money?* (Auburn, Al.: Ludwig von Mises Institute, 1990); idem, *The Case Against the Fed* (Auburn, Al.: Ludwig von Mises Institute, 1994); Hans-Hermann Hoppe, "How is Fiat Money Possible? - or, The Devolution of Money and Credit", *Review of Austrian Economics*, Vol. 7, no. 2, 1994.

(8) On the fraudulent character of fractional reserve banking see Hans-Hermann Hoppe, Guido Huelsmann, Walter Block, "Against Fiduciary Media", *Quarterly Journal of Austrian Economics*, Vol. 1, no. 1, 1998 .

(9) See Milton Friedman, "The Resource Costs of Irredeemable Paper Money", *Journal of Political Economy* (1986).

(10) See further Hans-Hermann Hoppe, "Banking, Nation States, and International Politics", *Review of Austrian Economics*, Vol. 4, 1989; Guido Huelsmann, "Political Unification: A Generalized Progression Theorem", *Journal of Libertarian Studies*, Vol. 13, no. 1, 1997.

(11) The same limitation regarding the issue of "fiduciary media" (money substitutes not covered by money) applies also to a system of so-called "free banking". See Ludwig von Mises, *Human Action. A Treatise on Economics* (Auburn, Al.: Ludwig von Mises Institute, 1998), ch. XVII.

(12) See Robert A. Mundell, "International Monetary Options", *Cato Journal*, Vol. 3, no. 1, 1983.

(13) See further Jacques Rueff, *Balance of Payments: Proposals for the Resolution of the Most Pressing World Economic Problem of Our Time* (New York: Macmillan, 1967); idem, *The Monetary Sin of the West* (New York: Macmillan, 1972).

(14) See further Murray N. Rothbard, *Wall Street, Banks, and American Foreign Policy* (Burlingame, Ca.: Center for Libertarian Studies, 1995); idem, *A History of Money in the United States* (Auburn, Al.: Ludwig von Mises Institute, 2003).

(15) See further Murray N. Rothbard, *The Case for a 100 Percent Gold Dollar* (Auburn, Al.: Ludwig von Mises Institute, 1991).

(16) See further Ludwig von Mises, *Theory and History. An Interpretation of Social and Economic Evolution* (Auburn, Al.: Ludwig von Mises Institute, 1985).