

*Notas*



# THE CHICAGO PLAN REVISITED: AN AUSTRIAN CRITIQUE

MARIUS KLEINHEYER<sup>1</sup>

*Fecha de recepción:* 19 de diciembre de 2015

*Fecha de aceptación:* 27 de marzo de 2016

## I INTRODUCTION

Within the context of the economic crisis since 2007 a space for fundamental reflection on the institutional structure of the financial system has been opened, allowing for the introduction of significant reform proposals in the economic discourse. The IMF economists Jaromir Benes and Michael Kumhof published a working paper in August 2012, reintroducing the Chicago Plan as such a proposal.<sup>2</sup> Following up the work of Irving Fisher (1935)<sup>3</sup> the authors propose the separation of the monetary and the credit functions of the banking system, by requiring 100% reserve backing for deposits. This plan is designed to eliminate the possibilities for private banks to create money through fractional reserve banking and is supposed to give governments the complete control over money issuance. The central bank, upgraded as a powerful monetary commission, is seen as the best candidate to serve as a state's monetary authority in the exercise of its monetary prerogative (monopoly of currency, money issuance, and seigniorage).

The purpose of this paper is to provide an overview of the elements of this reform proposal, contrast it with a recapitulatory

---

<sup>1</sup> Profesor de Macroeconomía en Universitat Erfurt (Alemania).

<sup>2</sup> Benes/ Kumhof (2012) *The Chicago Plan Revisited*, IMF Working Paper

<sup>3</sup> Irving Fisher (2007) *100%-Geld*, German translation of 100%-Money (1935)

display of the Austrian analysis and evaluate the plan based on its political desirability.

In the first step, the original plan from 1935 by Irving Fisher is presented. Second, the newest version and the key findings of Benes and Kumhof are summarized. Third the Austrian critique of fractional reserve banking and central banking is laid out. In the fourth step, a response to a peculiarity of the working paper about the origin of money is offered. In conclusion a brief discussion on the likelihood of political implementation and the evaluation from the Austrian perspective close the argumentation.

## II

### «100%-MONEY» BY IRVING FISHER

The stock market crash of 1929 was a key moment in the life of Irving Fisher not only academically but also, because he lost a substantial part of his fortune. Until his death in 1947, Fisher dedicated his efforts to research the fundamental economic dynamics of boom and bust cycles, to bring forward policy recommendations supporting recovery and stabilization, to educate a general public and to convince those holding political power.<sup>4</sup> The quintessential work to reach his objectives was his book «100%-Money»<sup>5</sup> which contains a brief summary of his reform proposal for non-economists and a following elaboration of his version of the Chicago Plan.

Fisher proposes to cut the link between the creation of check-book money<sup>6</sup> and the creation of credit. Therefore he wants to establish a Currency Commission, which buys bank assets in order to oblige them to back their deposit accounts with a 100% reserve of government issued currency. The growth of bank credits is directly linked to the growth of savings.

---

<sup>4</sup> Allen (1993) p. 703.

<sup>5</sup> Fisher (2007)

<sup>6</sup> Also called deposit money.

## 1. Fractional Reserve Banking

Fractional reserve banking is seen as the core of unstable capitalism. Banks are not merely the safe keeper of money but together with the debtors in control of the amount of money. The relation between the bank and the debtor does not only affect the involved parties but the public in general.

The process of boom and bust cycle in the fractional reserve banking system according to Fisher is the following: New investment opportunities arise for example due to innovation. This leads to general optimism of economic actors and higher profit expectations, boosted to unrealistic profit expectations. The willingness to lend money and on the other side to lend out money rises. Over-indebtedness occurs if the expectations are unjustified but optimism is still fueled by irresponsible behavior and fraud. If the expectations are getting disappointed, the process of credit creation stops, amortization and termination of credits as well as bailouts take place, changing the atmosphere of the financial markets. Within the system of fractional reserve banking this leads simultaneously to the rapid contraction of deposit money. The debt crisis endogenously converts into a deflation crisis leading the system through a self enforcing mechanism into a vicious circle including bankruptcy, unemployment and a high level of poverty. According to Fisher, without counteraction the cold turns into a pneumonia.<sup>7</sup>

In the fractional reserve system a credit contraction leads to a decline of deposit money, which causes a disproportionally high decrease in the price level. Although nominal indebtedness declines, real indebtedness in terms of goods and services increased due to deflation.

The economically prudential decision of individual actors to decrease debt leads to higher debt levels and enforces the severity of the economic downturn. The more debts are liquidated the higher the debt level is. In this deflation scenario, money is needed most urgently exactly when no one will take on debts. The only hope is that the state plunges into debt but thereby it is rising future debt burden.

---

<sup>7</sup> Fisher (2007) p. 83.

The same effect leads in the beginning of the process to a self enforced build up of the credit pyramid. An increased demand for credit can be followed by a growth of the amount of deposit money and the accompanying rise of the price level lowering the real interest rate and provoking even more credit extension. Fisher compares the system with a too big scope of a steering wheel. The only barrier for this development would be the willingness for banks to satisfy the demand for credit.

In the process of liquidating credits, banks are competitors for cash because they have to run up their reserves. This process in turn leads to a further withdrawal of money and the slow down of money velocity. The need of banks to power up their reserves also let policy measures prove futile initially. Any provision of money supply is first of all used for reserve backing, which takes valuable time in the face of the crisis. Again, Fisher uses an illustrative analogy. In the fractional reserve system, one need to fill the basin first. The 100% system already provides a filled basin. Every additional drop already overflows.

## **2. 100% Reserve Banking**

Primary objective of Fisher's reform proposal is the fight against the depression resulting of the debt-deflation process. In the longer run a 100% reserve banking system also prevents bouts of credit expansion in the first place. To attack deflation, a reflation through the means of government is envisioned. This means that a monetary commission is built to issue government currency in exchange for bank assets to back deposit money in the current accounts and to reestablish the pre-crisis price level.

The supply of money is independent from the amount of credits and not necessarily subject to a certain monetary policy. In fact, theoretically the amount of money could stay completely unchanged.<sup>8</sup> After the reflation process, the only task of the monetary commission could be the administration of the existing amount or the implementation of a certain growth rule. This, according to

---

<sup>8</sup> *Ibid.* p. 68.

Fisher does not need to be more discretionary than the driving of a chauffeur subject to a fixed route prescribed in detail.<sup>9</sup>

The lending business of banks reduces basically to the intermediation between borrowers and savers. Consequentially, the credit growth depends on the growth of savings. Interest rates would express the price as a result of supply and demand.

In the long run GDP would be higher in the 100%-system since without volatility including repeating depressions, growth path would be slower but constant.

However, Fisher does also see a place for active monetary management. He sees policy measures in a 100% reserve environment as much more effective. Banks who get offers to sell funds to the monetary commission only do so for channeling money to productive investment opportunities. He adds that if banks refuse to sell, the monetary commission can use other ways to transmit new money in the market, for example directly to the public.<sup>10</sup>

For Fisher, the only reason this system could be dissolved is a lack of commitment for example due to a big enough war. As soon as the short-term survival is at stake, long-term monetary stability issues lose priority. The government could create a war bond, which will be bought by the monetary commission with newly created money.

### III

#### «THE CHICAGO PLAN REVISITED»

BY JAROMIR BENES AND MICHAEL KUMHOF

In 2012 Benes and Kumhof pick up the idea of Irving Fisher and publish a reassessment of his vision against the background of the actual financial crisis and the empirical findings for example of Reinhart and Rogoff.<sup>11</sup> In accordance with Fisher, the authors present six advantages, which make the plan a highly desirable policy: (1) Better control of money supply and credit increases and contractions.

---

<sup>9</sup> *Ibid.* p. 23.

<sup>10</sup> *Ibid.* p. 75.

<sup>11</sup> Reinhart/Rogoff (2009) *This Time is different*.

(2) Eliminations of bank-runs. (3) Reduction of public debt. (4) Reduction of private debt. (5) Output gains. (6) Zero steady state inflation without problems for monetary policy. In addition, the functions of the private financial system like capital allocation or payment-systems are in their view not restricted or unsettled.

## 1. The Transition Period

The main changes in the bank balance sheet can be illustrated in an approximate single transition period model.

The left balance sheet represents the financial system prior to the implementation of the Chicago Plan. The asset side consists of government bonds, short-term and mortgage loans as well as investment loans. The liabilities are deposits and the bank equity. The transformation takes place in two stages. First, banks take out loans from the monetary commission or the treasury<sup>12</sup> to fully back their deposits. As a result, the balance sheet extends to reserves on the active side and treasury credit on the liability side both equaling the amount of deposits. Then, treasury credit is cancelled against all debts except investment loans. Equity is reduced due to much reduced capital adequacy requirements. In the right column the separation between the money function and the credit function is illustrated with the thick black line. As Benes and Kumhof point out: «Money remains nearly unchanged, but it is now fully backed by reserves. Credit consists only of investment loans, which are financed by a reduced level of equity and what is left of treasury credit after the buy backs of government and private debts and the injection of additional credit following the equity payout».<sup>13</sup>

The output gain is reached for three reasons: First, there is a reduction of interest rates because of lower debt levels. Second, significantly higher seigniorage income permits lower tax rates. Third, the more stable credit structure demands lower monitoring costs.

---

<sup>12</sup> In Benes/Kumhof it is already the treasury itself

<sup>13</sup> Benes and Kumhof (2012) p. 7.

FIGURE 1  
CHANGES IN BANK BALANCE SHEET IN TRANSITION PERIOD<sup>14</sup>

| Prior to Chicago Plan |                               | Chicago Plan 1 |                               | Chicago Plan 2 |                  |
|-----------------------|-------------------------------|----------------|-------------------------------|----------------|------------------|
| 20                    | Gov. Bonds                    | 20             | Gov. Bonds                    |                |                  |
| 100                   | Short-Term and Mortgage Loans | 100            | Short-Term and Mortgage Loans | 184            | Reserves         |
|                       |                               | 184            | Deposits                      |                | 184              |
| 80                    | Investment Loans              | 80             | Investment Loans              | 80             | Investment Loans |
|                       |                               | 16             | Equity                        |                | 71               |
|                       |                               |                |                               |                | Treasury Credit  |
|                       |                               |                |                               | 9              | Equity           |
|                       |                               | 184            | Reserves                      |                |                  |
|                       |                               |                |                               |                |                  |
|                       |                               | 184            | Treasury Credit               |                |                  |

In this model, there is no room for liquidity traps. The aggregate quantity of money in private agents' hands can be directly increased by policymakers, without depending on banks' willingness to lend. Additionally, interest rates can drop under zero, because the interest rate on treasury credit is not an opportunity cost of money for asset investors, but rather a borrowing cost rate for a credit facility that is only accessible to banks for the specific purpose of funding physical investment projects.<sup>15</sup>

## 2. The Long-Run

The vision of Benes and Kumhof for credit banks is, opposed to the original plan, not dedicated to the establishment of quasi investment trusts, issuing equity and their own private non-monetary

<sup>14</sup> Benes/Kumhof (2012) p.64.

<sup>15</sup> *Ibid.* p. 8.

securities to channel savings and fund lending. They see banks issuing their debt instruments exclusively to the government. Treasury credit in turn is only accessible to banks. The government is furnished with the ability to charge banks negative interest rates on treasury credit. There is no natural rate of the policy interest rate, the government is free to choose the steady state rate.<sup>16</sup> As a result, the authors see the credit function executed by private institutions that fund investment loans mainly with treasury credit at a policy-determined rate.

In the model, government affects the price of lending not only through interest rates on treasury credit but also through quantitative lending targets. The government can impose very costly capital adequacy regulations, designed to prevent moral hazard.<sup>17</sup>

Moral hazard is modeled as an incentive for banks to not protect themselves against negative shocks to profits that are larger than their existing equity base. Therefore, in the absence of regulation, banks have an incentive to take on large amounts of lending risk and to minimize their own equity base. The basic understanding is that bankers, operating under limited liability, need to be disciplined by regulation, not that regulation produces bankers with limited liability.

«The Chicago Plan Revisited» explicitly refers to the proposal of Irving Fisher as a forerunner. However, his version is very different with regard to how investments are funded.

#### IV AUSTRIAN CRITIQUE

One cornerstone of Austrian Business Cycle Theory is the awareness of the importance of monetary explanations for cycles, namely that under the existing credit organization monetary fluctuations must inevitably occur and must represent an immanent feature of the economic system.<sup>18</sup> The institutional arrangement of

---

<sup>16</sup> *Ibid.* p. 39.

<sup>17</sup> *Ibid.* p. 39.

<sup>18</sup> Hayek (1933) p. 80.

the monetary deposit-contract leads to the creation of new money via loans, unbacked by an increase of voluntary savings. This officially guaranteed routine leads to serious profound distortions in the market process. Another cornerstone is the connection between the monetary theory and Austrian capital theory, defining capital as the subjective market value of capital goods.<sup>19</sup> With this definition in mind one can perceive capital theory as conceptual point of origin for the Austrian analysis of entrepreneurship, knowledge or socialism. Austrian Capital theory is the unique feature in the different approaches to 100%-reserve banking and deserves therefore further elaboration.

The assignment of capital in the production process as the key entrepreneurial role leads to the inter- and intratemporal coordination of heterogeneous resources.<sup>20</sup> The constant decomposition and reformation of production processes in the immanent indissoluble environment of uncertainty constitutes the most efficient or even the only possible way to organize meaningful economic activity. In society this requires the free exercise of the entrepreneurial function.<sup>21</sup> The quality of institutional arrangements can be measured by the effect they have on the entrepreneurial function.

## 1. Critique of Fractional Reserve Banking

For the continuous and sustainable growth and development of society, voluntary saving plays a pivotal role. A new credit *ex nihilo*, with no prior increase in saving does raise the amount of credit, for the sake of the argument, exclusively for investment projects and is therefore also widening and lengthening the productive structure. The immanent problem emerges because economic agents receive wrong signals. «Although the amount of capital goods available did not increase, the calculation employs figures which would be utilizable only if such an increase had taken place.

---

<sup>19</sup> Huerta de Soto (2009) p. 282.

<sup>20</sup> Foss (2012) p. 154.

<sup>21</sup> Huerta de Soto (2013) p. 15 ff.

The result of such calculations is therefore misleading. They make some projects appear profitable and realizable which a correct calculation, based on interest rate not manipulated by credit expansion, would have shown as unrealizable. Entrepreneurs embark upon the execution of such projects. Business activities are stimulated. A boom begins.»<sup>22</sup> This is the description of the intertemporal discoordination effect. Investors behave as if there were savings, consumers do not change spending behavior or might even increase expenditures due to the experience of rising prices.

There is not only intertemporal distortion, there is also intratemporal distortion famously expressed very early by Richard Cantillon. Money is not neutral but enters the economy at discrete points. According to Cantillon, the important question is in what way and in what proportion the increase of money raises prices. «All this increase of expense in Meat, Wine, Wool, etc. diminishes of necessity the share of the other inhabitants of the State who do not participate at first in the wealth of the Mines in question.»<sup>23</sup>

Already the Spanish Scholastics observed this phenomenon of inflation, without using the word itself. For example Juan de Mariana wrote the book «De monetae mutatione»<sup>24</sup> in which he made the distinction between a king, who respects natural law, and a tyrant. «The tyrant is he who tramples everything underfoot and believes everything to belong to him, the king restricts or limits his covetousness within the terms of reason and justice.»<sup>25</sup> Not within these terms was the action of the Spanish king during the lifetime of Juan de Mariana, wiping out his domestic debt by counterfeiting the amount of metal used in minting the coins thereby increasing money supply three-fold and diminishing purchasing power of the citizens.<sup>26</sup> «Foolish, nay, wicked the ruler who orders that a thing the common people value, let us say, at five should be sold for ten. Men are guided in this matter

---

<sup>22</sup> Mises (1998) p. 550.

<sup>23</sup> Cantillon (2001) p. 68.

<sup>24</sup> Engl. «The Alteration of Money».

<sup>25</sup> Quoted in Huerta de Soto (1999) p. 3.

<sup>26</sup> Laures (1928) p. 147.

by common estimation founded on considerations of the quality of things and of their abundance or scarcity. It would be vain for the prince to undermine these principles of commerce.»<sup>27</sup>

The intratemporal effect of credit extension without an increase in savings leads to redistribution and disturbs relative prices. Only a relatively small number of economic agents receives the new purchasing power and enjoy significantly increased market power. This is the underlying foundation of the Schumpetarian entrepreneur as a creative destructor receiving laurels in advance from society for risky undertakings. «In this deeper sense he (the entrepreneur) is so to speak a debtor of society»<sup>28</sup> This social forgoing does not happen consensual but is forced. Since there is no amount of corresponding voluntary saving backing the newly created credits *ex nihilo*, it is impossible to complete the new, more capital-intensive stages undertaken.<sup>29</sup>

Fractional reserve banking misleads the entrepreneurial function and has damaging economic effects. This is suggested both by the Chicago Plan and Austrian analysis.<sup>30</sup> The integrated approach of Austrian capital theory is able to demonstrate in a singular fashion the profundity of this claim.

Nonetheless, many Austrian economists defend fractional reserve banking as a means for matching up supply of money with the demand for cash balances. A detailed analysis would go far beyond the scope of this article.<sup>31</sup> At this point it should be pointed out, that under the institutional arrangement of central bank managed fiat money, the adverse effects of fractional reserve banking are aggravated since there are no reliable adjustment mechanisms.

---

<sup>27</sup> Quoted in Rothbard (1995) p. 120.

<sup>28</sup> Schumpeter (2008) p. 102.

<sup>29</sup> Huerta de Soto (2009) p. 412.

<sup>30</sup> Both approaches also claim a violation of traditional legal principles. Fisher identifies fractional reserve banking as prestidigitation (Fisher (2007) p. 34). For an elaborate analysis see Huerta de Soto's first chapter (2009).

<sup>31</sup> See for example Selgin (1988), Huerta de Soto (2009), Bagus and Howden (2010)

## 2. Critique of Central Banking

Austrian Capital theory leads to the theorem of the impossibility of socialism. Applied to the monetary system this means a finite use of a central bank as a financial central-planning board not only in the case of a fractional reserve system but also and especially in the case of a monetary commission managing the banking sector under a 100% reserve ratio. The four basic arguments against central planning hold true for the monetary commission: First, it is impossible for the agency to constantly assimilate the enormous volume of practical information stored in the minds of different human beings; second, the subjective, practical, tacit and nonverbal nature of most of the necessary information precludes its transmission to the central organ; third, information which actors have not yet discovered or created and which simply arises from the free market process, itself a product subject to the law, cannot be transmitted; and fourth, coercion keeps entrepreneurs from discovering or creating the information necessary to coordinate society.<sup>32</sup>

Analyzing the current banking system, it is clearly a flawed logic to deduce from the obvious fact, that fiat money is created by banks organized in private corporate structure,<sup>33</sup> to the conclusion that the monetary system is privatized. Moral hazard does primarily not occur because of limited liabilities of bank clerks and managers or its constitution as a corporate entity but because the implicit insurance of the central bank to provide liquidity when needed. This is the mandatory other side of the coin of the privilege for banks to operate under a fractional reserve banking. Consequently, under a 100% reserve system also the scope for bank regulation is finite.

Central banks face an inevitable knowledge problem not knowing the subjective valuations of economic agents and not knowing the dynamic changes in subjective valuation due to measures of central bank policy, which always require time as they are realized in the market.

---

<sup>32</sup> Huerta de Soto (2009) p. 650.

<sup>33</sup> For historical reasons Germany has many banks governed under public law.

Additionally, central banks are subject to pressures and dynamics typical for bureaucratic organizations including ideological biases especially in the monetary field. By trend this leads to financial laxity since raising interest rates are politically unpopular especially before elections. This is the reason why independence of central banks is aspired to a larger extent.

In the 100% reserve system, the stability of the monetary value is exclusively dependent on the commitment of the government to provide sound money and therefore the stableness of the deciding policy maker. The empowerment of monetary commissions to directly control the amount of money and the amount of credit intensifies and escalates public pressure. In the worst case, the only effect of the Chicago Plan is the complete centralization of an inflationary policy regime without any resistance.

The rationale for central banking is to offset market failures of the financial system. Of course, the theoretical justification does not explain which performance the specific institutional arrangements actually show. The constitutional independence of the central bank is theoretically instrumental in establishing sound money based on trust. But if there is no commitment to the rule in crucial moments it proves not only useless but takes advantage of the trust put in it. An ideal working system of public fiat money may be superior to a worldly private monetary system but that doesn't lead to a preferable institutional arrangement.<sup>34</sup> An illustrative example is given by Richard Wagner, writing about the Public Choice perspective on central banking: «Suppose someone were to say that there would be a social saving from replacing our present system of personal security, in which resources are tied up in locks, guns, dogs, police, and the like, with a system of trust and love<sup>35</sup>». In this line of argumentation lies the skepticism of the ordoliberal school, otherwise open to the original Chicago Plan.<sup>36</sup>

Public Choice and ordoliberal school theorists face the dilemma of choosing a monetary system which avoids anarchic money

---

<sup>34</sup> Garrison (1983) p. 235.

<sup>35</sup> Wagner (1986) p. 522.

<sup>36</sup> Eucken (2004) p. 260.

production on one side and the discrete power of monetary authority on the other.

Buchanan states, that to allow separate banks to create short-term liabilities to a multiple of the base money on the asset side of the account removes from the issuing authority some of the control of the aggregate amount of that value treated as money in the economy without offsetting benefits, thereby making the financial structure vulnerable to unpredictable shifts among instruments, which, in turn, generate changes in real values.<sup>37</sup>

He concludes, that the system in existence emerged from a historical process, the characteristics of which were partially appropriate for a monetary standard defined in terms of some commodity base, but which, ultimately, make no sense under a fiat system.<sup>38</sup>

The analysis of Buchanan demonstrate his deep roots in the tradition of the early Chicago School and his appreciation for the analysis of the original Chicago Plan, when it comes to the constitutionalization of money.<sup>39</sup>

Fisher himself shows the path to dissolve the monetary system of the Chicago Plan in case of a big war.<sup>40</sup> It is very possible that the government does not hesitate to find other reasons to exert influence on the monetary commission for example financing public provision of energy, infrastructure, pension system etc. or even out of diplomatic reasons. The insights of fiscal constitutionalism suggest a strong disposition for fiscal illusion and debt financing.<sup>41</sup>

Austrian analysis suggests that fractional reserve banking in connection with central banking is damaging for the economy. Also, Austrian analysis suggests, that central banking with a 100% reserve regime, envisioned by the early Chicago School theorists and picked up by Kumhof and Benes does not guarantee a more stable system. Insights of public choice including fiscal constitutionalism are skeptical about the effect of centralized monetary power under the control of a government monopoly.

---

<sup>37</sup> Buchanan (2010) p. 255.

<sup>38</sup> *Ibid.* p. 257.

<sup>39</sup> Burns (2016) p. 1-20.

<sup>40</sup> Fisher (2007) p. 77.

<sup>41</sup> Brennan/Eusepi (2004) p. 66.

### 3. Critique of the History of Money

The working paper of Benes and Kumhof only refers to the contribution of the Austrian School once, discussing the debate on the origin of money. It is worth to quote at length: «The monetary historian Alexander Del Mar (1895) writes: “As a rule political economists do not take the trouble to study the history of money; it is much easier to imagine it and to deduce the principles of this imaginary knowledge.” Del Mar wrote more than a century ago. But this statement still applies today. An excellent example is the textbook explanation for the origins of money, which holds that money arose in private trading transactions, to overcome the double coincidence of wants problem of barter (reference to Menger (1892) *On the Origins of Money*). As shown by Graeber (2011), on the basis of extensive anthropological and historical evidence that goes back millenia, there is not a shred of evidence to support this story. Barter was virtually nonexistent in primitive and ancient society and instead the first commercial transactions took place on the basis of elaborate credit systems whose denomination was typically in agricultural commodities, including cattle, grain by weight, and tools. Furthermore, Graeber (2011), Zarlenga (2002) and the references cited therein provide plenty of evidence these credit systems, and the much later money systems, had their origins in the needs of the state and of social ceremony, and not in the needs of private trading principles<sup>42</sup>».

Several things need to be pointed out. First, the Mengarian approach to the origin of money is simply not a todays textbook explanation but appeared before the comment of Del Mar. As the founder of the Austrian School he highlighted in the *Methodenstreit* the importance of theory to arrive at economic laws. Indeed, the concrete historical singular evolution of human institutions does not provide deeper insight in the essence of economic institutions and still less provides guidance for its regulatory design. His depreciative description of the method of political economists has indeed a valid point of how Austrians gain insights. The Robinson Crusoe economy is not a historical attempt to explain production

---

<sup>42</sup> Benes/ Kumhof (2012) p. 12.

but indeed an imaginary thought experiment built on ones observation of the external world and ones own consciousness. One employs extraspection and introspection<sup>43</sup> and deduces principles.

Second, elaborating on Menger, Ludwig von Mises holds that «if the objective exchange-value of money must always be linked with pre-existing market exchange-ratio between money and other economic money economic goods (since otherwise individuals would not be in a position to estimate the value of the money), it follows that an object cannot be used as money unless, at the moment when its use as money begins, it already possesses an objective exchange-value based on some other use. This provides both a refutation of those theories, which derive the origin of money from a general agreement to impute fictitious value to things intrinsically valueless and a confirmation of Menger's hypothesis concerning the origin of the use of money<sup>44</sup>».

Third, Graeber himself refers to Carl Menger in the following way: «Economists like Karl Menger and Stanley Jevons later improved on the details of the story, most of all by adding various mathematical equations to demonstrate that a random assortment of people with random desires could, in theory, produce not only a single commodity to use as money but a uniform price system<sup>45</sup>». One cannot exclude the possibility of confusing the economist Carl Menger with his son, Karl Menger, a well-known mathematician. In any case, Graeber is not responsive to the Austrian approach. Additionally, later in the book, Graeber does not state that barter was nonexistent, but that it was nonexistent within a tribe but established between different wandering tribes. For the economic perspective, the only precondition for the working of the theory is that there was a notion of different correspondent valuations of things and people acted upon this valuation.

History has shown both government and private control over money issuance. Instead of refuting the theory of the origin of money, an anthropological approach can enrich the understanding of historical circumstances and illustrate developments. It certain-

---

<sup>43</sup> Rothbard (2002) p. 31.

<sup>44</sup> Mises (1998) p. 405.

<sup>45</sup> Graeber (2011) p. 38.

ly does not provide evidence for a prerogative of state controlled money. Of course power existed before trade and dependency existed before credit. But the essence of money remains the marketability as a medium of exchange. Its discovery remains the exercise of entrepreneurship.

## V CONCLUSION

If the Chicago Plan will never seriously be considered in the legislative process, it is highly unlikely that this happens on the basis of the Austrian critique. Irving Fisher was confident, that bankers and governments would be in favor of his plan if only they would understand to the full extend the implications and improvements from which they would benefit from.<sup>46</sup> It is very unlikely. Especially banks would lose their privilege and would be easy targets for competition and innovation. Banks would be deprived of their commercial basis.

The goals of the modern version of the Chicago Plan are diametrically opposed to the objectives of the Austrian School for a sound monetary system: Monetizing debt, making accessible a funding source for government, and design a central authority, the monetary commission, by extending their competence from being monetary planners to becoming financial planners, directly interfering with their loan and business strategy. In this way, the central banker would become the embodiment of the Schumpetarian ephor in the exchange economy.<sup>47</sup>

Even so, there is a characteristic in the proposal, which is very appealing for the Austrian minded political strategist. By the virtue of eliminating fractional reserve banking, the veil of obscurity in the financial system is lifted significantly. The aforementioned fiscal illusion is deprived of an important tool and government action is getting more traceable. That was also clear

---

<sup>46</sup> Fisher (2007) p. 111

<sup>47</sup> Schumpeter (2008) p. 74 compares the banker with this ancient Greek powerful controller of public works in *Theory of Economic Development*.

to Irving Fisher.<sup>48</sup> Even if government lacks commitment for monetary rules, they cannot violate them but only in an evident and obvious way in the eyes of the public. That would be a significant improvement.

## REFERENCES

- ALLEN, WILLIAM (1993) *Irving Fisher and the 100% Reserve Proposal*, Journal of Law and Economics (October 1993), p. 703 – 717.
- BAGUS, PHILIPP and BAGUS, HOWDEN (2010), *Fractional Reserve Free Banking: Some Quibbles*, Quarterly Journal of Austrian Economics, Vol. 13, No. 4, p. 29-55.
- BENES, JAROMIR and KUMHOF MICHAEL (2012) *The Chicago Plan Revisited*, IMF Working Paper: <http://www.imf.org/external/research/index.aspx>.
- BRENNAN, GEOFFREY and EUSEPI, GIUSEPPE (2004) *Fiscal Constitutionalism*, in: Handbook of Public Finance (2004) Backhaus, Jürgen and Wagner, Richard E. (Ed.), Kluwer Academic Publishers: Dordrecht, Ned.
- BUCHANAN, JAMES (2010) *The Constitutionalization of Money*, Cato Journal, Vol. 30, No. 2 (Spring/Summer 2010).
- BURNS, SCOTT (2016) *Old (Chicago) school, new century: the link between Knight and Simons' Chicago plan to Buchanan's constitutional money*, Constitutional Political Economy, p. 1-20.
- CANTILLION, RICHARD (2001) *Essay on the Nature of Commerce in General*, Transaction Publishers: London.
- EUCKEN, WALTER (2004) *Grundsätze der Wirtschaftspolitik*, Mohr Siebeck: Tübingen.
- FOSS, NIKOLAI J. (2012) *The Continuing Relevance of Austrian Capital Theory*, The Quarterly Journal of Austrian Economics, Vol. 15, Nr. 2 (Summer 2012), p. 151 – 171.
- GARRISON, ROGER (1983) *Gold: A Standard And An Institution*, Cato Journal, Vol. 3, Nr. 1 (Spring 1983), p. 233 – 238.
- GRAEBER, DAVID (2011) *Debt, The First 5000 Years*, Melville House Publishing: New York.

---

<sup>48</sup> Fisher (2007) p. 78.

- HAYEK, FRIEDRICH A. VON (1933) *Monetary Theory and the Trade Cycle*, in: *Prices and Production and Other Works* (2008), Salerno, Joseph (Ed.), Ludwig von Mises Institute: Auburn, Alabama.
- HUERTA DE SOTO, JESÚS (1999) *Juan de Mariana: The Influence of the Spanish Scholastics*, in: *15 Great Austrian Economists* (1999), Holcombe, Randall G. (Ed.), Ludwig von Mises Institute: Auburn, Alabama.
- (2009) *Money, Bank Credit and Economic Cycles*, Ludwig von Mises Institute: Auburn, Alabama.
- (2013) *Sozialismus, Wirtschaftsrechnung und unternehmerische Funktion*, Lucius & Lucius: Stuttgart.
- LAURES, JOHN, S.J. (1928) *The Political Economy of Juan de Mariana*, Fordham University Press: New York.
- MENGER, CARL (1892/ 2009) *On the Origins of Money*, Ludwig von Mises Institute: Auburn, Alabama.
- MISES, LUDWIG VON (1998) *Human Action*, The Scholar's Edition, Ludwig von Mises Institute: Auburn, Alabama.
- FISHER, IRVING (2007) *100%-Geld*, Verlag für Sozialökonomie: Kiel.
- WAGNER, RICHARD E. (1986) *Central Banking and the Fed: A Public Choice Perspective*, *Cato Journal*, Vol. 6, Nr. 2 (Fall 1986), p. 519 – 543.
- REINHART, CARMEN and ROGOFF, KENNETH (2009) *This time is different*, Princeton University Press: Princeton.
- ROTHBARD, MURRAY N. (1995) *Economic Thought Before Adam Smith*, Ludwig von Mises Institute: Auburn, Alabama.
- (2002) *The Ethics of Liberty*, New York University Press: New York.
- SCHUMPETER, JOSEPH A. (2008) *The Theory of Economic Development*, Transaction Publishers: New Brunswick, New Jersey.
- SELGIN, GEORGE (1988) *The Theory of Free Banking: Money Supply under Competitive Note Issue*. New Jersey: Rowman and Littlefield.

