

# Goldmoney Insights<sup>®</sup> Special Edition

## The Golden Revolution, Revisited: Chapter I

This Insight is the third in the serial publication of the new, Revisited edition of my book, *The Golden Revolution* (John Wiley and Sons, 2012). (The first instalment can be found [here](#).) The book is being published by Goldmoney and will also appear as a special series of Goldmoney Insights over the coming months. This instalment comprises the first chapter of Section I.



### On the Misunderstanding of Money

*“[Adam] Smith, far from being the founder of economics, was virtually the reverse. On the contrary, Smith actually took the sound, and almost fully developed subjective value tradition, and tragically shunted economics on to a false path, a dead end.”*

MURRAY ROTHBARD

*“Money is gold and nothing else.”*

JP MORGAN

For something used nearly every day by nearly every person on the planet, money is much misunderstood. Yet it is arguably the single greatest invention of civilization. Indeed, one could plausibly claim that without at least some form of money, however primitive, civilization becomes impossible. For without some means to avoid direct

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barter in economic transactions, there is simply no way to divide up labor and capital beyond the close social ties of the family, extended family, or tribe. Without an extensive division of labor and capital, insufficient specialization of both precludes the ability to form the larger social units required to organize towns, cities, countries, empires, and their respective governing institutions. Even if we are to allow for at least the possibility that primitive civilizations could exist absent money, they would almost certainly remain confined to a stone-age level of organization.

Indeed, the history of all the great civilizations, and right up to the present day, is to a necessary extent a history of money. The Sumerians, arguably the oldest of old, invented a monetary unit based on a ration of wheat or barley, the shekel, and specified a corresponding weight of silver to provide the unit of account and serve as the de facto monetary base. The Lydians of Asia Minor invented modern coinage, later adopted by the highly commercial Athenians and thereby spread throughout the Hellenistic world. The Roman golden solidi and silver denarii would in time displace Athenian coinage, until their gradual, multi-century debasement resulted in their own displacement by the Byzantine solidi, or bezants as they were known in western Europe.

Around the time of the fall of Byzantium in 1453, out of the ruins of the western Roman Empire, arose the great Renaissance. At first Portugal, then Spain, France, the Netherlands, and finally Great Britain provided the bulk of the coinage that would dominate in international commerce and serve as reserves in the relatively simple banking systems of the time. Innumerable local, domestic coins would circulate alongside and be changed and exchanged by weight and purity as required to facilitate local commerce. One silver coin in particular, the “thaler” of Bohemia, would provide the name basis for the Spanish “dolar” or “piece of eight.” The United States would adopt this particular silver coin, or at least the specific weight thereof, as the basis for the first official US federal money in the Coinage Act of 1792, which also monetized gold at a ratio of 15:1 vs. silver by weight.

Notwithstanding periodic experiments with paper money and occasional modifications to its coinage, the US would remain on a metallic monetary system of some sort until 1971, when by executive order President Nixon brought this convention to an abrupt end in arguably unconstitutional fashion, transforming the dollar into an unbacked fiat currency. (Switzerland would become the last country to formally sever the link between its national currency and gold in 1994.)

## CONFUSING MONEY WITH DEBT

The history of money is not only a history of coinage, however. It is also a history of bills, banknotes, and other forms of coinage receipts, which frequently circulated alongside actual coins. As these were explicit claims on coins (or bars) held in a secure vault and available on demand, these did not represent debt but rather alternative, more convenient forms of money, fully backed by actual money—gold or silver most commonly—held in, say, a bank or private vault.

The history of money is, however, intertwined with a history of debt. Indeed, it can be argued that money is simply debt with a zero maturity, one that is simultaneously originated and liquidated at the same moment, as an exchange takes place—when the exchange is agreed, the debt is originated. When the money changes hands, the debt is extinguished. (As the origination and liquidation occur essentially simultaneously this could also be thought of as taking place in reverse order.) But if there is an interim period during which money is not immediately exchanged for goods or services rendered, then a debt remains outstanding, denominated in the monetary unit and perhaps one accruing interest over time.

The topic of debt can lead to potential confusion around money. This is because debts can circulate at a discount to actual money as money substitutes. The size of the discount imputes a rate of interest on the debt. The rate of interest carries with it two components: time value and credit risk. The former is based on the economic concept of “time preference,” that consuming goods or services today is always preferable, if only at the margin, to consuming them at some point in the future. Hence, the rate of interest is naturally positive, if perhaps approaching zero under certain circumstances. (It would be wholly unnatural for the time value of money to be outright negative due to the immutable Second Law of Thermodynamics, entropy. Ask a physicist.)

Credit risk is some estimation of the probability that the lender will not be paid back in full, if at all, when the payment comes due. The higher the perceived credit risk, the higher the interest rate. Other factors equal, credit risk also increases with time, but this should not be confused with the pure time value of money. Rather, it is due to the uncertainty of repayment, which normally grows ever higher as maturities increase. Even the most creditworthy of borrowers tend to have a life span of no more than several hundred years.

Although they might originate out of the same social evolutionary processes, money and debt are nevertheless different. Debt is first originated in exchange for money and is subsequently settled when the principal and interest are repaid under terms

of the contract. Money itself bears no interest as it represents the final settlement and any associated claims of either a liquidation of debt, or an exchange of goods. The relationship between money and debt can, however, lead to much confusion, for example, in David Graeber's best-selling book *Debt, the First 5,000 Years*.

Graeber makes some bold claims in his book that on close inspection do not hold up to scrutiny. The one that I will address here is that in the history of civilization, the use of debt long preceded the use of money and that direct barter was, in fact, uncommon. In Graeber's view, debt provided the basis of primitive, altruistic, "gift-based" economies in which favors given at one point in time are subsequently returned at a future point in time, and that the exchange of such "gifts" formed the transactional basis of the ancient civilizations, beginning with ancient Sumeria. While direct barter may still have taken place—it is impossible after all to prove a negative—Graeber claims that it played a relatively minor role, and money arrived on the human scene much later not as a substitute for barter but as a substitute for debt.

Now, I am no anthropologist and I would not presume to question Graeber's observations, only his interpretations and conclusions so following. For example, Graeber observes that in the ancient Sumerian economy bushels of wheat or barley in fixed amounts ("shekels") were exchanged for "gifts" of various kinds, rather than for any actual money. The value of the shekel was, however, linked to an amount of silver, which was stored in the temples and did not itself circulate domestically. But rather than imply a nonmonetary economy this is in fact strong evidence that a relatively fixed amount of silver reserves provided the de facto Sumerian monetary base, even if the circulating medium of exchange happened to be that of the bushels themselves. This is no different in principle to a system of circulating silver-backed banknotes, although banknotes are not necessarily self-liquidating, as with bushels. But as the bushels are constantly being produced into and then consumed out of existence, the "money" supply can therefore be considered essentially stable, when adjusted for the natural seasonality. In any event, the silver provides the monetary base and a specified weight of silver—also known as a shekel—functioned as the official government unit of account, including for use in calculating taxes. The taxes were then also generally paid in bushels—the medium of exchange—but this remains at base a silver-backed monetary system, not one based on gifts or other unsecured debt, although Graeber so claims.

Another important point Graeber makes about primitive commerce is that whereas within a given civilization, what he calls "debt" is used in exchange, when trading with foreigners, actual money frequently trades hands. In the case of the Sumerians, this

would mean that in trade with non-Sumerians, not only might bushels be exchanged, but the silver itself. Now, as the silver was held at the temples, then presumably such trade would be primarily official in nature and thus quite possibly for relatively large sums. But that does not in any way diminish the importance of silver backing the domestic money as the ultimate form of settlement. Nor does it support Graeber's claims that "debt" rather than money was the basis for trade. Indeed, foreign trade might have been of great importance at times. But it is understandable why foreigners, operating outside the Sumerian legal system and possibly within quite different social customs, would not trust a "gift"—an offer of credit—from the Sumerians in exchange for goods. Nor should the Sumerians have been expected to trust in foreigners' credit, for the same reasons.

This is an absolutely essential point: real money does not require a third party to verify it and enforce its use and value. It has what is frequently called intrinsic value, that is, value independent of any official agency or specific legal system. However, money substitutes do require some form of third-party verification for acceptance. Debt not only requires such verification but even the reverse, in that debt contracts must not only be verifiable but enforceable by law, or they become worthless.

Graeber's anthropological evidence is clear: where trust is lacking, such as at the international level, real money trumps debt. The implications of how foreign trade ultimately relies on monetary (silver) exchange, or possibly direct barter, rather than on the origination and liquidation of debt will be explored in a more contemporary context in our discussion of international monetary relations and game theory in Section III.

### **THE CLASSICAL ECONOMIC VIEW ON MONEY**

Since antiquity, theologians and philosophers have pondered certain basic elements of what is today defined as "economics." The systematic study of economics, however, only really got going in the 1700s, and is referred to as "classical economics." Adam Smith is considered the father of classical economics due to the tremendous influence of his primary work on the subject, *The Wealth of Nations*. His eloquent presentation of many basic principles of economics, such as the productive power of the division of labor and capital, the self-regulating role of the marketplace—the fabled "invisible hand"—and the benefits of free trade, have rightly earned him a prominent place in the history of economic thought. That said, Smith's thoughts on money, as presented in *The Wealth of Nations*, are relatively simplistic and dangerously misleading.

In contrast to Graeber's revisionist view, Smith was of the belief that the use of money

did indeed originate as an alternative to barter, rather than as an alternative to debt. Smith argued that barter was cumbersome and did not allow for much specialization and hence division of labor and capital. The use of money was, therefore, essential to economic progress and to growing the wealth of nations, which for Smith meant total productive potential rather than mere acquisition of specie reserves in the Treasury. He also held that for money to be useful it should be sound, which in his day meant that it had to be something tangible rather than just paper promises to pay (IOUs). He thus also argued against the debasement of money, something that he associated with the rampant, nationalistic mercantilism of the day and that he believed interfered with free and fair trade between and within nations, hence impeding economic progress and wealth creation generally.

Smith's observations above certainly seem reasonable enough and, for the most part, have stood the test of time. But the reader of *The Wealth of Nations* is almost left with the impression that Smith would prefer not to analyze money in much detail. For example, he does not distinguish clearly between the money supply provided by specie and that provided by circulating banknotes, or "real bills"—receipts for circulating goods. To Smith, as these forms of money and money substitutes are all fungible, they are all basically the same in their economic purpose and effects. But surely they are not the same—a claim on specie is not the same as specie itself. This is especially the case in the event that the circulating notes or bills are not 100 percent reserved by the issuer(s). Smith did not perceive, or if he did he failed to mention, that in the circulation of fractionally reserved bills and notes there existed the possibility for pernicious monetary inflation, or for credit risk to creep into the financial system, thereby destabilizing and undermining commerce.

Smith had an equally simplistic understanding of credit and interest, although he understood intuitively that the rate of interest must be linked in some way to the productivity of capital. How else could debt be serviced at a given interest rate, if the capital stock were not sufficiently productive to generate the necessary interest income? As capital productivity increased, so did the rate of interest, and vice versa. The same relationship also held for land and rents. For Smith, the "invisible hand" was just as much at work in matters of credit, interest, and rent as it was in the marketplace for goods. (As a professor of moral philosophy and as a deeply religious Scottish Presbyterian, Smith did support usury laws prohibiting lending to the poor at what he considered to be extortionate rates of interest. In general, however, he had no problem with a free market in credit and interest.)

Unsurprisingly, Smith's somewhat simplistic understanding of money is not considered

among his more notable achievements. But it is surprising indeed why this is so. Smith was a close friend of fellow philosopher David Hume, whose price-specie-flow mechanism was a notable step in the development of the historically prominent quantity theory of money. Moreover, Smith cites the work of Richard Cantillon, some of which he borrows nearly verbatim. Yet he essentially ignores Cantillon's comparatively sophisticated views on money, which we will examine in some detail later. Finally, and most surprising of all, in *The Wealth of Nations* Smith fails to include even his own monetary theories in detail, even though these had formed the basis of his previous, documented lectures on money at the University of Glasgow!<sup>1</sup>

One possible explanation for Smith's facile treatment of money in his magnum opus is that, at time of writing, there was a major academic and even political dispute regarding the relatively new institution of fractional-reserve banking—regulated with disputed success by the Bank of England—and the wide circulation of banknotes that were claims, albeit unallocated, on specie. Smith may have determined that it was best to present an essentially neutral position on the matter, given that the primary purpose of *The Wealth of Nations* was to discredit the mercantilists, not to advance any specific monetary theory or take sides in what Smith might have regarded as a relatively unimportant matter.

Regardless, notwithstanding the sheer size and scope of *The Wealth of Nations*, Smith had little to say about money, credit, and interest. His successors, including the flamboyant businessman David Ricardo, did attempt to build on his limited insights. But they did so within a monetary framework which was, for those who put so much faith in the “invisible hand” of the dynamic, free marketplace, surprisingly rigid and mechanical. It is as if Smith and his classical successors shared his somewhat puritanical moral sentiments about what money should be—a fair and neutral mechanism for the distribution of economic goods—and allowed this to skew their conclusions about how money in fact functions in the economy and the hidden or not so hidden dangers of monetary inflation and fractional reserve banking.

## THE QUANTITY THEORY OF MONEY

Although one can trace its antecedents back to ancient times, the modern Quantity Theory of Money (henceforth QTM) was developed during the enlightenment by David Hume and John Stuart Mill. The equation  $MV = PQ$ , is the classical expression of a mechanistic monetary framework based on the QTM. By way of explanation:

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1 Murray Rothbard, *An Austrian Perspective on the History of Economic Thought*, vol. II (Mises Institute: 1995).

M = the money stock

V = the “velocity” of money, that is, how many times it changes hands in a given period

P = the price level

Q = economic output

According to the quantity theory, increases in the money stock pass through more or less mechanically and neutrally into the general price level. As for more sophisticated variations, a money injection will first increase Q, the quantity of economic output, but this is due only to so-called money illusion, that is, the misperception that increased nominal demand, following from the increase in the money supply, is in fact increased real, sustainable demand. Once the money injection has run its course, however, real demand slips right back to where it was, with real output unchanged and the price level simply higher to reflect the net increase in the money supply (i.e. more money chasing the same amount of goods).

Note, however, that nowhere in the discussion above does velocity—the circulation rate of money—explicitly enter the picture. Sure, it figures in the equation above, but it does not play an active role; it remains a constant. There is a reason for this: attempts to model changes in the velocity of money have never borne much fruit. This is due perhaps to the highly capricious nature of money demand through history. Occasionally it moves higher, occasionally lower. Abrupt shifts happen from time to time. Sometimes these are so abrupt they defy any rational economic explanation at all.

Take for example the great German Weimar hyperinflation of 1922–23. Yes, money velocity had been on the increase in 1922, but for reasons that may remain forever unknown in their exact specifics, something snapped in 1923 and what had been a gently rising price level suddenly phase-transitioned into a “get rid of money at all costs; buy and hoard anything not bolted down” mentality. Money velocity soared. Germans suddenly began to dump money in exchange for any and all real goods and eschew holding cash balances. This withholding of goods from circulation—a negative supply shock—locked the economy into a self-fulfilling vicious cycle of rising prices and an associated further decline in productive economic output. To use an astronomical metaphor, it was as if the economy had passed the monetary event horizon from which there was no escape from total collapse. Bartering with real goods—including silver and gold but more commonly bread, eggs, milk, or cheese—became the norm.<sup>2</sup>

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<sup>2</sup> The economic and broader social aspects of the Weimar collapse receive a most compelling treatment in Adam Ferguson’s modern classic, *When Money Dies*.

The Weimar experience eludes any attempt to model what precisely caused the abrupt shift in the velocity of money. Nobel laureate John Sargent once published a paper examining various hyperinflations in history and concluded that there was simply no way in which the quantity theory  $MV = PQ$  framework could even begin to explain either how they began or how they ended.<sup>3</sup> What did explain them, he found, were significant, qualitative changes in the composition of the government and the associated impact on fiscal policies and expectations thereof. That is, when a government lost fiscal credibility in the eyes of the public, hyperinflations began. When a new government with sufficient fiscal credibility arrived on the scene, hyperinflations ended.

While this is perhaps an entirely correct assessment, it is a deeply unsatisfying one from the perspective of the modern economics profession, which prefers and purports to be able to model any and all significant economic phenomena according to some equation or set of equations. Those phenomena that do not fit into equations are generally just dismissed from the data set entirely as aberrations, as freak events, as historical developments that are so unlikely to be repeated that it is not worth bothering thinking about them much.

This procrustean academic mentality, that that which does not fit neatly into equations should simply be cut off from the discipline, smacks of the faith-based, “paradigmatic” thinking that Thomas Kuhn disparages in his seminal history of science, *The Structure of Scientific Revolutions*. It is narrow, shallow, and downright dangerous when such thinking informs economic policy, especially at a time when debt levels, economic leverage, and imbalances are all at record levels relative to incomes. The risk of a phase transition from a stable to unstable monetary order is clearly high at present, and just because there is no precise way to model the pure uncertainties around just how this could happen does not at all imply that we should not try to consider what the consequences are likely to be, the focus of sections III and IV of this book.

### **MILTON FRIEDMAN AND THE MONETARIST “CHICAGO SCHOOL”**

Regardless of the QTM’s obvious shortcomings, this mechanistic, quantity-based approach to modeling money was rebranded, revitalized, and expanded to inform economic theory more generally by Milton Friedman and his fellow “Chicago School” Monetarists of the mid-twentieth century, who reminded the then Keynesian-dominated economics profession that “Inflation is, always and everywhere, a monetary

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<sup>3</sup> Thomas Sargent, “The Ends of Four Big Inflations,” in Robert Hall, ed., *Inflation Causes and Effects* (University of Chicago Press, 1982).

phenomenon.” Yes, velocity might be a capricious factor evading attempts to capture it in equations. Yes, prices might also be “sticky,” as the Keynesians alleged. And yes, economies do have their other rigidities and imperfections, but to the Monetarists, traditional Keynesian aggregate demand management was so demonstrably unworkable and potentially counterproductive that some other basis must be found to nudge an economy toward equilibrium when necessary.

For the Monetarists, the ideal way to manage an economy was to allow money to fulfill its central, essential function as a source of stability. The growth of the supply of money need only be held more or less constant at a rate commensurate with potential output growth and all other things will, in one way or another, sort themselves out in time. Independent, wise, and capable central bankers, as guardians of the money supply, could ensure that economic cycles were generally smooth and that growth could reach its potential, whatever it was, through some form of monetary targeting. In the event that an economy was to slip into a so-called liquidity trap or other state of structural disequilibrium, there was, somewhere to be found, a workable if possibly radical monetary solution.

Recent attempts to find monetary solutions to perceived disequilibria abound. Since 2008 we have observed a range of monetary experiments ranging from negative real (i.e. inflation-adjusted) interest rates; zero rates; negative rates; quantitative easing; long-dated asset purchases; and purchases of corporate and mortgage securities in addition to government bills or debt. Japan, of course, has been on the search for alternative monetary solutions for a good while longer, with clearly limited if any success.

Indeed, it is fair at this point to pose the question as to whether there exists any workable monetary solution to the general problem of excessive debt and economic leverage at all. But if there is not, then the Monetarists are wrong. If the Monetarists are wrong, then the modern economics profession’s understanding of money is wrong. Could it be that, somewhere along the way, perhaps to avoid the uncomfortable difficulties of modeling money velocity and demand, some false assumptions were absorbed into the economic mainstream? Let’s look for an answer to this question by going way back, to the preclassical economist mentioned earlier, Richard Cantillon.

## **THE (MOSTLY) FORGOTTEN MONETARY THEORIES OF RICHARD CANTILLON**

While it is lamentable that Adam Smith failed to incorporate Richard Cantillon’s

sophisticated monetary theories, it is downright curious that his twentieth-century successors, the Monetarists, have also done so. I have speculated as to the explanation for Smith's neglect. It could be that he simply wasn't interested in the subtle, monetary aspects of economics and chose to prioritize those topics that he believed had a more direct and obvious role in determining the wealth of nations, such as the division of labor and capital. But as the Monetarists have always focused predominantly on money, one would have thought that they would have sought out preclassical works on monetary theory, including that of Cantillon.

The Monetarists also rose to prominence well after economist William Jevons had rediscovered and popularized Cantillon's work in the late nineteenth century. Thus, they should have given him far more serious consideration. That they did not is most unfortunate, because the fact is that, far from holding a simplistic, mechanistic view on money, Cantillon saw it as a dynamic force and potentially damaging source of economic turbulence. Indeed, Cantillon's theories arose largely out of the great French inflation associated with the disastrous monetary policies implemented by John Law. Given that Cantillon's monetary theories were based in large part on his direct observations of the broad economic effects of John Law's money injections, perhaps we should not be so surprised to make similar if less obvious or self-evident observations amid the generally inflationist monetary policies in place today. Correlation is not causation, to be sure, but there is certainly enough accumulated circumstantial evidence to form a credible hypothesis. Unfortunately, in the social sciences, including economics, properly controlled experiments are not possible. However, as we delve deeper into the work that has been done on understanding and analyzing Cantillon effects, we shall see that there is strong theoretical support for certain historical developments, including those of today, that might be dismissed by some as mere coincidence.

John Law is one of the more colorful characters in the long (and occasionally rather sordid) history of monetary policy. By all accounts, Law was a genius. He could calculate large sums in his head, including the probability calculations required to win at gambling. Something of a ladies' man as well, in 1694 Law found himself engaged in a duel over a young lady and although he won, he also killed his opponent in the process and found himself temporarily imprisoned. As was not uncommon at the time, some of Law's family relations apparently offered a bribe to secure his release, and Law then escaped English jurisdiction, at first fleeing to Amsterdam and then on to Scotland.

While in Scotland, Law published a paper on money and proposed the creation of a

Scottish national or central bank. Although this proposal was rejected it raised his profile, including in France, where he eventually settled. In 1716 he made a similar proposal to the Banque Generale, the Bourbons' bank. The plan for the bank included the issuance of currency that was nominally backed by gold, but in fact only fractionally reserved. This allowed for the bank to operate with enormous leverage, lending out large sums to state monopoly companies, including the Mississippi company operating in the New World.

Due to his growing involvement in both domestic and international financial activities, in 1720 state regent Phillippe of Orleans appointed Law the Controller General, giving him effective control not only over banking and currency policy but also state finances generally. This dual role of being both head of the Treasury and of the de facto central bank allowed Law to fully indulge and implement his plans for a financial system of paper currency, backed by credit, and fractionally reserved banking. The associated, huge expansion in the supply of both money and credit facilitated a huge boom, as documented here by the New York Federal Reserve:

In 1719, the French government allowed Law to issue 50,000 new shares in the Mississippi Company at 500 livres with just 75 livres down and the rest due in nineteen additional monthly payments of 25 livres each. The share price rose to 1,000 livres before the second installment was even due, and ordinary citizens flocked to Paris to participate. Based on this success, Law offered to pay off the national debt of 1.5 billion livres by issuing an additional 300,000 shares at 500 livres paid in ten monthly installments.

By mid-1719, the Mississippi Company had issued more than 600,000 shares, and the par value of the company stood at 300 million livres. That summer, the share price skyrocketed from 1,000 to 5,000 livres and it continued to rise through year-end, ultimately reaching dizzying heights of 15,000 livres per share. The word millionaire was first used, and in January 1720 Law was appointed Controller General.

Everything seemed to be going just fine. But as with all such booms, the rise in asset prices, in order to continue, needs a constant supply of new money and credit. It is not clear whether Law understood this. Regardless,

...in early 1720 some depositors at Banque Generale began to exchange Mississippi Company shares for gold coin. In response, Law passed edicts in early 1720 to limit the use of coin. Around the same time, to help support the Mississippi Company share price, Law agreed to buy back Mississippi

Company stock with banknotes at a premium to market price and, to his surprise, more shareholders than anticipated queued up to do so. To support the stock redemptions, Law needed to print more money and broke the link to gold, which quickly led to hyperinflation.

The spillover to the economy was immediate and most notable in food prices. By May 21 (1720), Law was forced to deflate the value of banknotes and cut the stock price. As the public rushed to convert banknotes to coin, Law was forced to close Banque Generale for ten days, then limit the transaction size once the bank reopened. But the queues grew longer, the Mississippi Company stock price continued to fall, and food prices soared by as much as 60 percent.<sup>4</sup>

In a final, desperate attempt to salvage what was left of his schemes, Law criminalized the sale of gold in hope of stabilizing the value of the currency. When that didn't work, he attempted to criminalize the very ownership of gold itself, something that would not have been enforceable without turning France into a police state. As the pathology of Law's program became ever more apparent to the Duke of Orleans and his advisors, they finally moved to shut it down.

Notice this particular sequence of events as they play out above. At first, fueled by new money and the associated credit expansion, share prices soar. Thereafter, once the money and credit spigot is turned off, the bubble begins to collapse as those who had profited from the share appreciation seek to cash out. But they don't just cash out into cash. The wealthy are generally somewhat clever in managing their financial affairs and, knowing full well that the system was fractionally reserved, they cash out for gold instead.

Law is now trapped. He attempts to salvage his failing monetary and banking system by breaking the link to gold, but, having now made this explicit, even the poor now lose confidence in the unbacked fiat currency as a store of value and they dump it for food, clothing, and shelter—for anything of tangible value. But as the poor were on the final receiving end of the new money, rather than the initial injection, they end up even poorer than before in effective purchasing power terms. The wealthy, by contrast, had the opportunity to grow their wealth, if only temporarily. And they also had the option, while the boom was underway, of taking profits by cashing out and moving into gold, as some of them chose to do early in 1720.

When the smoke cleared from the economic rubble, a handful of wealthy people had

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<sup>4</sup> James Narron and David Skeie, "Crisis Chronicles: The Mississippi Bubble of 1720 and the European Debt Crisis," New York Federal Reserve, 10 January 2014.

become wealthier still, a vast number of ordinary people had become impoverished, and a good number of the already impoverished had become even more so. Law, in the meantime, had fled France, in the middle of the night, for fear of his life. He took up gambling with his own money, rather than that of other people, and due to his undoubted intelligence made a modest living. Yet he died in relatively poor circumstances, absent family or friends, in Venice in 1729.

John Law was more than just a colorful character; he was in fact way ahead of his time. Indeed, he conceived in some detail the modern monetary structure most take for granted today: a sole, central bank as money issuer; money backed by debt rather than a tangible commodity; fractionally reserved banking; and the highly flexible, at times aggressive, use of all the above to stimulate an economic boom through financial speculation, with apparent benefits at first, only to be followed by an inevitable market crash and economic bust. While they might not consider things in quite this way, Greenspan, Bernanke, Yellen, and their colleagues and counterparts in the US and abroad are all monetary practitioners in the Law tradition. We have experienced their booms and busts on prior occasions. It is highly likely that, as long as the current monetary policy regime so continues, we will experience them again.

Living as we are in an age of banking and financial crises, Cantillon's monetary insights are worthy of fresh consideration. Moreover, Cantillon's remarkably advanced monetary theories also include a compelling explanation of how monetary policies can contribute, if in mostly subtle, unseen ways, to growing wealth inequality over time. Indeed, a thorough exploration of his insights is essential to understanding contemporary economic developments generally. It is to this we turn in the following chapter.