Monetary theory and policy: the difficult relationship of Menger's theory of money and his positions on currency reform and monetary policy

Günther Chaloupek, Director (retired) of Economics Dpt., Chamber of Labour, Vienna

Paper presented to the international conference Carl Menger One Century Later, Nice, November 24- 26, 2021

ABSTRACT The contribution attempts an evaluation of Menger's theory of money by comparison of his *Geld*-article (1892/1909) with his statements in the context of the introduction of the gold standard in the Austro-Hungarian monarchy in 1892. In the first place, this concerns the goal of constancy of the value of money, but also his theory of money under uncertainty, his attitude towards the banking system, and other issues. The contribution also discusses the fundamental political dimension of pursuance of monetary policy goals and the anti-interventionist orientation of the economic liberalism of the representatives of later generations of the Austrian School.

Introduction; Menger's theory of money

In Carl Menger's bibliography the year 1892 stands out for its exceptional number of publications. All of them are contributions to issues of monetary policy - in the context of the currency reform of the Austro-Hungarian monarchy - and monetary theory – Menger's article *Geld* in the *Handwörterbuch der Staatswissenschaften,* It was more than twenty years after publication of the *Grundsätze* that Menger came out with an extensive essay in the theory of money, a subject upon which he had rather briefly and selectively touched before. The theory of money was the last major field of economics to which Menger made a substantial contribution, which he revised twice for subsequent editions of the *Handwörterbuch*. Otherwise, he wrote mainly book reviews and other small pieces on a variety of subjects, while he also worked on an extended version of the *Grundsätze* which was published only after his death by his son Karl Menger.

In the *Grundsätze,* there is a separate chapter on money. The major part of the text deals with the historical evolution of money as a generalized means of exchange – a phrase not yet used by Menger. He emphasizes that, for any commodity to become money, its acceptability in exchange for all other commodities by all participants of the exchange process was decisive. "Custom and practice" were the main driving forces in the evolution of money, whose origin is "entirely natural". "Money is not an invention of the state", which "is not responsible for the money character of a good, but for a significant improvement of its money-character."[1] Menger also emphasizes that the functions of money as "measure of value" and as "store of

[1] Menger 1976/1871, p. 261f

value must not be attributed to money as such, since these functions are merely accidental and are not an essential part of the concept of money" (p. 280)

In the *Investigations* Menger points to money was a prominent example of those "social phenomena which are not a product of agreement or of positive legislation, but are unintended results of historical development"[2], "that the origin of money can be brought to our full understanding only by our learning to understand the social institution … as the unintended result, as the unplanned outcome of specifically individual efforts of members of a society"(p. 155). In the historical process Menger's principal emphasis is on exchange. Intensification of exchange of goods and services and the perfection of monetary instruments as mediators of this exchange mutually enforce each other, thereby acting as powerful drivers of overall economic progress.

Apparently, it was the debate about Austria's currency problems which motivated Menger to work on a more comprehensive theory of money, in parallel with his detailed contributions to the ongoing debate about the currency reform. As a result, the handbook article came out in print in the same year when his articles on the reform appeared in the German periodical *Jahrbücher für Nationalökonomie und Statistik.*

With respect to the role of money in a fully developed capitalistic market economy Menger's general propositions can be summarized in the following way.

i. Security and stability of the monetary system of a country are essential for a correct evaluation of goods in terms of money and for an efficient use of economic resources. [3] He emphasized "the role of money prices as indispensable of economic calculation and rational resource allocation in a dynamic world."[4]
ii. What in Menger's view the implications of "stability of the monetary system" for prices are is not easy to find out from his writings and was – as I believe – not entirely clear to himself. Menger introduces a principal distinction between "outer" and "inner exchange value" ("*äußerer*" and "*innerer Tauschwert*"[5].

[2] Menger 1985/1883, p. 139
[3] Menger 1909, p. 72
[4] Salerno et al., p 703
[5] Menger 1909, 73ff. The English translation of Menger's article available in Latzer/Schmitz (2002) uses "inner" and "outer" exchange value.

iii. The outer exchange value of money is determined by its purchasing power over all other goods. Differences in purchasing power in time or between countries can be measured by index numbers, which "are deficient in many respects, but nonetheless provide a useful basis for practical purposes."[6]

iv. With regard to the inner exchange value of money, Menger does not give a static definition of the concept. Instead, he speaks of changes of the inner value which are caused solely "by influences originating on the side of money"[7], not on the side of the other goods. Economic agents – consumers as well as producers – have a strong preference for an invariable measuring rod for the exchange value of goods. This misleads them "to disregard movements of the inner exchange value of money itself", and causes "a considerable lack of accuracy in the economic thinking of the masses"[8].

v. Because all prices of goods and the value of money with respect to them are mutually interdependent, there is no single good which could serve as invariable standard. But one can think of a good whose inner value can be kept constant in relation to the other goods "by appropriately regulating the quantity of that good which is brought to the market" – money. Menger goes on by stating that it is not impossible to "neutralize" ("*aufzuheben*")[9] the effects on the prices of goods "originating from an uninfluenced course of events on the side of money by deliberately influencing the circulating quantity of money, especially that of paper money". In this way, a "means of circulation can be established that exhibits a constancy of value in the desired sense."[10] Menger does not spell out explicitly the concrete implications how the "quantity [of money] circulating in internal trade" should be regulated. But the consequence of his postulate that no changes of the price level should originate from the side of money is that the quantity of money circulating in internal trade has to be kept unchanged, i.e. constancy of the money supply[11].

vi. Apart from its function of money as medium in current transactions in the goods' market and for hoarding and capital accumulation, money also only serves as a means to fulfill

[6] ibidem, p.77
[7] ibidem, p 81
[8] ibidem
[9] "Neutralize", the term I prefer as translation of the German word "aufheben", is different from that used in the translation of Menger's article available in Latzer/Schmitz (2002), p. 70, where "aufzuheben" is translated by "cancel out". In the following text, also "neutralize" is occasionally used for Menger's "aufheben". Campangnolo, in his translation of the French version of Menger's article, also uses "neutralize" (Menger 2005, p. 258).
[10] Menger 1909, p. 86
[11] Chaloupek 2021, p. 29

unilateral obligations.[12] It is essential to take full account of the fact that “no other of its functions claims so much money and is of such great significance for the economy as the function of money as intermediary in capital transactions (on the money market).” [13]

vii. The final section of his article deals with the demand for money, looked at from the viewpoint of the individual agent and from the economy as a whole. For recurrent transactions as well as out of precautionary motives, “units of the same type and size often have very different cash holdings” to provide “for a greater or lesser degree of security against disturbances in economic activity, the advantages of which they have to balance against the “necessary sacrifices” of foregone interest earnings.[14] Hence, the quantity theory and, in particular, the concept of velocity of circulation is misleading, if it relates the money demand of the economy as a whole to the volume of current transactions within a defined period. This approach neglects “that the amount of money which is used in actual payments constitutes only a part, and indeed a relatively small part, of the cash necessary to a people and that another part is held ... in the form of various reserves as a security against uncertain payments ... The cash reserves in the possession of the central bank, of the coffers of the state and local agencies, of the savings and loan associations, of the banks, and especially of entrepreneurs and private individuals – meant only for uncertain needs, for rare and unusual adversities, in part even against extreme circumstances – in spite of the fact that they are normally not used for payments, still form as much a part of the monetary requirements of an economy as the small amounts of small change in the possession of households which change hands several times a day.”[15] The more fully developed are the financial techniques of payment and credit and the banking business, the higher is the elasticity of the financial system to respond to changing needs for means of payment and for financial reserves. Hence, Menger welcomes a gradual emancipation of the monetary system from its metal base.

The currency reform of 1892 and the monetary system of the Habsburg monarchy

The gold standard as international currency system came into being during the 1870’s, when an increasing number of European states followed the decision of Germany in 1871 to make gold the basis of its national currency. If the Austro-Hungarian monarchy was the last of the major European powers to adopt the gold standard, this was due recurrent political and

[12] Menger 1909, p.46ff
[13] ibidem, p. 59
[14] Ibidem, p. 108
[15] Menger 1909, p. 109f

economic turbulences whose consequences for the monetary system could be overcome only towards the end of the 19th century.

For the major part of the 19th century, the monetary system of the Habsburg monarchy had been under severe strain or in disarray. During the Napoleonic wars inflation in Austria had become rampant due to excessive issuance of paper money. Silver convertibility was re-established in 1820 and lasted until 1848. Since then, redemption of paper notes remained suspended while several attempts to regain convertibility failed after Austria had gone to war (1859, 1866) or had become involved in international conflicts. After the final settlement of the conflict with Prussia in 1866 the newly formed double-monarchy of Austria-Hungary enjoyed a rare period of peace which lasted for almost 50 years during which state finances and the national currency system could be consolidated.

After 1866, the silver coin traded against paper notes of the guilder (fl) with an agio of 30%, which declined to less than 10% by 1873. During the 1870's, the agio disappeared gradually so that the Austro-Hungarian Bank (A-HB)[16] terminated minting coins on private orders in 1879.[17] Then something happened that was "an incomprehensive phenomenon for the orthodox doctrin"[18]: there was a disagio for silver against paper money. The theoretical silver equivalent of 1 fl could be bought for 96 to 99 kr (Kreuzer) until 1885, with this price declining to 75 kr by March 1892.[19] If Austria was theoretically still on a silver standard, the value of the Austrian paper money increased despite the fact that neither the national bank nor the state kept a sufficient reserve of precious metals during this period. Thus, the Austrian guilder represents an early case of a floating currency.

The declining price of silver reflects a fundamental change in the monetary systems of European countries which had occurred in the meantime. In the third quarter of the 19th century gold had gradually displaced silver as reserve metal.[20] Therefore, the fluctuations of the Austrian guilder against gold became the relevant relationship. With respect to the new standard for external valuta, a 10 fl gold coin issued in 1878 when the relation of silver to

[16] Together with the army and the ministry of foreign affairs the A-HB was one of the few joint institutions of the double monarchy.
[17] On the development of the Austrian currency system of monetary policy see Kamitz 1949, pp. 128ff; and März/Socher 1973, pp. 337ff, pp. 351ff
[18] Wieser 1909, p. 238
[19] Menger 1892a, p. 136
[20] Kindleberger 1984, pp. 54ff

gold was 1:15,5 served as a connecting bridge. Against paper notes the 10 fl gold coin traded for some 11,50 in 1879. This ratio increased to 12,4 in 1887 and then declined again to 11,7 in March 1892.[21]

Thus, in 1892 a constellation had emerged in which a compromise between the interests of the financial sector and of industry had become possible, while the government finances of both parts of the empire were sufficiently consolidated to make the necessary gold purchases. For a long time, Austria's manufacturing industry, and also Hungarian exporters of agricultural products, had opposed a currency reform because with a high gold agio products were more competitive on world markets. After the appreciation of the guilder from 1887 onwards they did not want this trend to continue much longer and were thus prepared to accept the going rate. In this situation of an appreciating external value of the guilder the Habsburg monarchy made its final decision to follow the other European powers in adopting the gold standard. With regard to the gold content of the new currency, the manufacturing industry's concern was that it should not be too high, whereas the financial industry favoured the opposite.

In the process of decision making, both the Austrian and the Hungarian parliament in early 1892 established "currency enquete commissions" in which the members of parliament discussed the various issues of currency reform with a number of experts chosen from the spheres of industry, banking, from the economic institutes of universities and from professional journals. In the Austrian case, 35 experts were heard, one of them Carl Menger. In the Austrian enquete commission, there was overwhelming support for the introduction of a gold backed currency. If only two members of the expert commission advocated a bimetallist currency system, they could support their case by pointing to the fact that in 1892 silver still accounted for almost 60 percent of the metal reserves of the A-HB. Its immediate replacement by gold, but also a decision to keep a substantial portion of reserves in silver entailed considerable risks for the success of the currency reform. Hence, the future composition of reserves and of money circulation remained a controversial issue, as well as the gold content ("weight"), the choice of the currency unit, and other modalities.

Carl Menger's tracts on monetary reform and his positions in the enquete commission

[21] Menger 1892a, p 147

In the enquete commission, Menger delivered his opinion on March 15, 1892, and then again replied to some of the other speakers on March 17[22]. Shortly before and after the hearings Menger published several articles on the subject which were reissued as pamphlets in June 1892.[23] Naturally, in the pamphlets he could elaborate his arguments at greater length and support them with statistical figures, than in the verbal statement, but the statements before the Reichsrat committee give a more vivid impression of what his concerns were.

Before that, Menger had published an article in the leading daily newspaper *Neue Freie Presse*, as a contribution to the debate about Austria's floating currency which had intensified during the 1880's. Therein, he had expressed his approval for the government's decision of 1879. He argued that the "artificial scarcity" of money was the reason why its "purchasing power had attained a level which exceeded the inner value of the effective silver guilder, or the silver guilder represented in surrogates,"[24] thus foreshadowing the concept of stability of the inner value of money. That the money supply changed much less than it would have without the termination of minting of silver coins does, however, not justify the conclusion that the purchasing power of the guilder has been kept stable. On the contrary, it is changing all the time with the changing phases of economic activity. Because of the "artificial" and therefore isolated character of Austria's monetary system these fluctuations are not smoothed – as is the case in countries with currencies based on the gold standard – by inward and outward capital flows. The external exchange rate of the guilder is an inadequate measure of changes in purchasing power which is essentially determined by internal conditions, especially the volume of money circulation and economic activity.[25] Menger concludes by stating that the provisional nature of Austria's currency regulation contains the risk ("serious danger") that the circulation of silver coins might rise again and therefore calls for a definite settlement of the issue.[26]

In his statement before the enquete commission, Menger generally supports the adoption of the gold standard – which appears neither exceptional nor original, since a far-reaching consensus had emerged some time ago. Of the 35 experts of the enquete commission, 34 were in favour of this alternative. Among the reasons why a currency reform was indispensable Menger mentions first that Austria's money and capital markets "are lacking the regulating

[22] For a survey of discussions among members of the enquete commission see Mataja (1893).
[23] Menger 1992a and 1992b
[24] Menger 1889, p. 120f
[25] ibidem, p. 122
[26] ibidem, p. 124

influence of inflow and outflow of money." As a consequence, interest rates were permanently higher in Austria.[27]

Still controversial were the modalities of transition and the composition of the money circulation and the choice of units. As a consequence of the increase of silver coins in the last years before 1879 and of the continued minting of silver by the government afterwards, they accounted for a considerable part – more than 5%, or 50 million fl - of total money circulation.[28] In addition, the A-HB held some 160 mill. fl unminted silver as reserves. To keep it or to sell the silver and buy gold instead would have implied a severe financial loss. Menger proposed to mint 100 mill. fl at the standard weight and put the coins into circulation, side by side with the gold coins. For such a "limping" gold standard ("hinkende Goldwährung") Menger put forward an interesting argument. If, at first glance, such a proposal seemed to defy Gresham's law, Menger insisted that there was another kind of law which could be derived from practical experience, not least from the surprisingly good experience with a floating currency : "The good money that is necessary for (orderly) commerce in a country confers its value upon the bad money which is circulating beside it. Gold determines the value of simultaneously circulating bad money as long as only a narrowly limited quantity of this bad money exists."[29] If the foreign exchange value of paper money unbacked by reserves of precious metal had risen to such height as in the case of the Austrian guilder, this would be possible also for a much smaller volume of circulating silver coins. The reason why Menger made such a strong plea in this case can be found in his theoretical considerations: an alternative solution of the problem would imply a loss for the national bank and marked reduction of the money supply.

With respect to the currency unit to be used after the currency reform, Menger objected to the proposal to switch from the traditional guilder to the crown (1 fl=2 K à 100 Heller). The advocates of the change argued that for practical purposes of the average household the guilder (and also the Kreuzer) was too large as a unit of account – not an unconvincing argument since 1 fl is equivalent to almost 10 € in present value! Moreover, the half-guilder (crown) was much closer to the German Mark (= 1,17 K) or the French Franc (0,95 K). Menger was sharply opposed to proposals to choose a unit exactly equivalent to 1 Mark or 1 Franc which would cause enormous inconvenience due to existing inertia of thinking and

[27] Menger 1892a, p. 138f
[28] ibidem, p. 161
[29] Menger 1892c, p. 247

habits in this sphere.[30] Similar arguments were used in the debate about the introduction of the Euro as single European currency. Menger was critical about the necessity of a change from guilder to crown even though the conversion of old into new prices would be easy[31]. If Menger argued for great caution with respect to changes in the currency unit, again this attitude is well founded in his theoretical considerations. If the level of uncertainty is raised, the consequence would be that entrepreneurs and households increase their precautionary – and perhaps also speculative – balances which would imply some disturbance of economic activities.

The central issue of the currency reform was, of course, the weight, or gold content, discussed by Menger mainly in terms of the valuta of the new guilder (or crown) vis à vis the Franc. Three alternatives were discussed: the going exchange rate, its average over a period of several years, possibly from 1879 to March 1892, and a rate that would anticipate future movements in the price of gold. Menger admitted that from the viewpoint of (formal) legal justice the going exchange rate should determine the gold content of the currency. However, he pointed out that exact numerical identity at the time of transition would not guarantee the stability of the value of the guilder/crown. Austria's experience since 1879 showed that the metallist doctrin that in the last instance money had its value in itself was wrong.[32] The members of the enquete commission who came from the banking and law branches expressed their indignation when Menger reminded them that it was "erroneous not to take into account changes in the value of money"- which are inevitably occurring – "in every day life."[33] If the emerging majority opinion tended to fix the gold content of the guilder at an exchange rate of 2,102 ffr for 1 fl (or 1,051 ffr for 1 K) which was almost identical with the actual rate at the time of the final debate and slightly higher than the 13 year-average (1879/91), Menger pleaded for a lower gold content ("light guilder") equivalent to an exchange rate of 2,05 ffr. He supported his vote with two main arguments. First, the appreciation of the guilder of some 8% between 1886 and 1891 had been caused by high surpluses in the trade balance of the monarchy which Menger did not expect for 1892 and the following years.[34] The going exchange rate (March 1892) therefore had an upward bias, even though it had dropped below the rates prevailing in 1891. Still more importantly, the likely consequence of the adoption of

[30] Menger 1892a, p. 177ff
[31] Menger 1892c, p. 266ff
[32] Menger 1892a, p. 173
[33] Menger 1892c, p. 284
[34] Menger 1892b, p. 201ff

the gold standard by a big European power like Austria-Hungary would be an increase in the price of gold. Menger estimated that in order to build up a sufficient reserve for its money circulation, Austria-Hungary would have to purchase an additional amount of some 285.000 to 300.000 kg of gold, an enormous quantity which amounted to some 10% or more of the total quantity of gold stored in all banks worldwide.[35] To avoid possible negative effects, Menger advised not to fix the gold content of the guilder at the date of transition but to wait and see how the gold price would develop until completion of the major part of the purchase.[36] Moreover, a guilder whose weight is too high entails the risk that a gold agio might reappear.[37]

Menger's cautious, comparatively "soft" position on the exchange rate-issue was based on theoretical considerations. For Menger, negative effects on economic activity in general could be expected not only from a decrease of the value of money but also from an increase. "Appreciated money is no less an anomaly of the national economy, in some respects even more pernicious, than depreciated money."[38] And : "What pernicious consequences for our commerce and for the whole economy money would necessarily have if its purchasing power would rise from year to year and from decade to decade and change all obligatory relations accordingly, hardly needs to be called to special attention."[39] Money serves its function best if it is protected against an increase as well as a decrease of its value.[40] At this point, it becomes clear what monetary stability and "neutralization" means for Menger: all influences should be neutralized which would force prices to fall.

Menger's testimony before the enquete commission also contains an important message for the national bank: that it must be ready to intervene in order to smooth the effects of inward and outward flows of money. "The people cannot (be expected to) take the necessary precautions to equalize the balance of payments in international money, i.e. in gold, if the need emerges. The Bank must be the precaution for the people. Under present conditions it has the great task to settle the international balance in circumstances where the (private)

[35] Menger 1892a, p. 166
[36] Menger 1892c, p. 266
[37] Menger 1892b, p. 217ff
[38] Menger 1892b, p. 206
[39] Menger 1892a, p.156; see also Menger 1892c, p. 257
[40] Menger 1892b, p. 207

economy could achieve this only by accepting great sacrifices."[41] This recommendation follows directly from Menger's theory of money under uncertainty.

Menger's recommendations in the light of post-reform developments

At the time when the final decision was made, the money supply of the monarchy consisted of bank notes, so-called "state notes" (*Staatsnoten* – state treasury notes), and silver coins. The A-HB's metal reserves in gold and silver were sufficient to fulfil the requirement for metal coverage of its own bank notes. The governments of Austria and Hungary committed themselves to withdraw state notes amounting to 412 million fl (824 million K) from circulation and replace them with gold by the end of 1899[42]. The question of the weight of the new currency was settled at a rate of 2,10 ffr for 1 fl, and not at 2,05, as Menger had proposed.

The provision of the gold reserves had to be financed by issue of government bonds on international financial markets. In this scenario, statutory resumption of payment in specie (*Barzahlung*) was envisaged as final step of the currency reform, which would become possible as soon as the state notes would have completely disappeared from circulation. However, no date was set as to when the A–HB would be obliged to payment in specie. For the time in between, the A-HB was obliged to prevent an increase of the exchange rate above gold parity, whereas it remained at the bank's discretion to counteract a movement in the opposite direction.

After the long series of historical mishappenings and unfortunate events in the second half of the 19th century, the currency reform of 1892 contributed significantly to the stabilization and consolidation of the economic and also of the political position of the Habsburg monarchy among the European powers. As it turned out soon, the change to the gold standard could be carried out according to plan, with only minor irritations.

However, that Menger's concerns about the effects of massive gold purchases turned out to be exaggerated, is largely due to unexpectedly favourable circumstances, and not to the better foresight of the decision makers. Eventually, effectuation of the gold purchases was much

[41] Menger 1892c, p. 250

[42] More precisely, circulating state notes of 1fl denomination lost legal tender status after 1899. State notes of higher denomination were replaced by fully covered bank notes and silver coins and ceased to be legal tender in 1903. For details see Fellner 1911, pp. 125ff.

easier than anticipated. The production of new gold continued to expand, and in the USA the advocates of silver gained the upper hand so that more gold was thrown on the market. Moreover, after a few years it became evident that the monetary system could be smoothly operated with only two thirds of the volume of gold originally deemed necessary.

Menger's concerns about a possible downward pressure on prices reflects actual trends of the two decades preceding the currency reform. If contemporary observers had called this period the "Great Depression", this characterization is hardly justified with respect to the development of the "real" economy. What contemporaries did not know but what we know today is that a substantial increase of real GDP took place during this period. But at the same time, the general price level was falling. In Austria consumer prices declined by 20 % from 1873 to 1892, and by 12% between 1879 and 1892[43], a wholesale price index shows a decline of almost 9% over the same period[44] – but a systematic observation of such facts was not possible at the time when the currency reform was debated. By the middle of the 1890's, the downward trend of prices had come to a halt and a period of modest inflation started. The gold crunch was an experience of the past.

Where Menger was proven right was the reappearance of a gold agio which reached its peak at 6,75% in 1893. For economists and politicians this phenomenon was both a great puzzle and a matter of great concern. Several factors seem to have contributed to the temporary fall of the exchange rate, such as a declining surplus in the trade balance, the return of a greater part of outstanding securities (including those issued to finance the gold purchases of the governments), the failure of the national bank to follow other national banks in raising the discount rate. Menger argued that the agio would not have increased to such numbers if the national bank had reacted immediately by using its gold reserves to buy the securities that were flowing back into Austria.[45] The highly undesirable return of the agio underlined the high significance of Menger's recommendation that "the Bank must be the precaution for the people." The agio disappeared until October 1895.

Digression: Friedrich von Wieser on currency reform

[43] Mühlpeck/Sandgruber/Woitek 1976, p. 678
[44] Mitchell 1978, p. 389 (based on Jankovich 1913).
[45] Menger 1893, p. 320ff. The same kind of criticism was made by the economist Max Wirth who argued that the Bank should have been willing to sell gold instead of defending its reserves in the same manner as „the dragon defended the Nibelung hoard." (Wirth 1894, p. 86)

At the time of the Austrian currency reform the fight between advocates of gold and silver, or of some mixture of the two alternatives (bimetallism, limping gold standard) was still ongoing. In the United States, the Sherman Silver Purchase Act of 1890 interrupted the decline of the price of silver for several years. Hence, the decision about the future currency system of the Austro-Hungarian monarchy, which was then still one of the major European powers, attracted considerable international attention[46]. Friedrich von Wieser was invited to contribute an article on the subject to the newly founded Journal of Political Economy (Wieser 1893).

In his article Wieser gives an overview of the development of the Austrian currency system after the suspension of specie payments in 1848. He argued that the principal question of adoption of the gold standard in Austria-Hungary had been decided beforehand by international developments in the preceding decades[47]. With respect to the envisaged resumption of (statutory) specie payments, Wieser thought that the major part of silver reserves would have to be converted into gold. This task would be even more demanding because in addition to the reserves a large amount of silver coins was part of the circulating stock of money. Thus, elimination of silver appeared to be impossible in the near future. On this point, Wieser agreed with Menger, that the monarchy would have a “limping” gold currency, and the experience of Germany showed that this was a system a country could live with quite well[48].

When Wieser commented again on the currency situation early in 1894, success of the reform had become more uncertain as the gold agio of the crown had increased above 6 percent. Wieser admitted that there were serious arguments in favour of bimetallism, which was an “effective counterweight against the excesses of overzealous goldmen”. But Austrians, even if they were bimetallists, had to devote all efforts to secure final success of the introduction of the gold standard; even more so, since the middle way chosen offered a compromise between gold and bimetallism.[49]

[46] A translation of the report of the currency commission appeared in the *Quarterly Journal of Economics* under the title “The Gold Standard in Austria” in 1893.
[47] Wieser 1929, p. 261
[48] Ibidem, p. 276f
[49] Wieser 1894, p. 17

If the governments of Austria and Hungary had hitherto not encountered difficulties to realize the gold purchases according to plan, Wieser also admitted that a shortage of gold at the international markets might result in downward pressure on the domestic price level. Yet, distortions of price levels between gold countries and silver countries would constitute the more serious risk of disturbance of the development of prices. Being less concerned about deflation, Wieser argued that if gold would eventually appreciate, this would be the lesser evil, because Austria would share it with its trading partner countries.[50]

If success of the currency reform could still be endangered, it was from the side of public finances, which had all too often resorted to the issue of paper money in the preceding decades of the century. “The agio is the paper money, and paper money is the budget deficit. “ Since the state budgets of Austria and Hungary had been effectively brought under control, the country “will soon get rid of paper money. There is no reason any more to fear the agio, as long as orderly public finances are maintained.”[51]

At the end of his lecture, Wieser expressed disagreement with Menger’s attentism concerning the capacities of the A-HB and the governments to accelerate the elimination of the agio. Austria and Hungary should be determined to proceed with their gold purchases to enable a swift building up of gold reserves of the bank. Instead of waiting for an improvement of economic conditions through the working of spontaneous market forces, it was time to realize that “the economic state (*Wirtschaftsstaat*) which the socialists strive for (albeit in a different fashion) is already in the making”, and to make full use of its powers to complete the reform[52].

The “Mengerian heritage” and its ambivalence

According to Schumpeter, the last decade of the 19th century marks a watershed in the evolution of the theory of money. It witnessed the emergence of “a new doctrine of money”. If, in previous periods, theoretical work reflects contemporary events, as does, e.g., monetary theory in the Ricardian epoch with respect to the currency turmoil causes by the Napoleonic wars, the new doctrine is “the result of analytical work per se, which would have been brought forward even without the stimulus of practical problems.” Looked at in these

50 Ibidem, p. 23
51 Ibidem, p. 25
52 Ibidem, pp. 27f

categories, Menger's contribution to monetary theory belongs to the previous period. A "climax of the older monetary theory", it shows how far one could advance on its ground[53].

In his *Geld*-article, Mengers's principal concerns – apart from money's historical evolution – are careful discussion and clarification of the functions of money and the introduction of a conceptual distinction between outer and inner value of money, always with respect to their policy relevance. In the last section on the demand for money criticizes the mechanical approach of the quantity theory, emphasizing the significance of money holdings as precautions for uncertainties, with foregone interest earnings as price for higher security. As far as it goes, this analysis is just a starting point for an investigation of the role of monetary factors for the dynamics of the economy, on which Menger did not embark. Whereas his emphasis on different motives for holding cash balances points in the direction of a Keynesian liquidity preference theory of interest and a theory of money under uncertainty, the investigation was further pursued by Menger's follower Ludwig Mises, and later by Hayek, on the basis of Wicksell's approach.

In evaluating Menger's positions in monetary theory and policy in the light of his Geld-article and his writings in the context of the currency reform debate in the Austro-Hungarian monarchy, two major issues are central:

(i) his discussion of the value of money and the quest for its stability; and
(ii) the relationship of his propositions for monetary policy and economic liberalism.

Ad (i) In the Geld-article Menger postulates constancy of inner value as a policy goal, in the sense that no effects should originate from the side of money on the price of goods. If in an expanding economy, i.e. with increasing national product and growing population, all effects from the side of money on prices are neutralized, the inevitable consequence is that prices have to fall. The postulate of constancy of inner value would result in a secular trend of declining price level as a consequence of increasing productivity of labour. It is hard to understand that Menger does not mention this consequence. Different form the articles which Menger published on the currency reform, in the handbook-contribution references to actual practical experience appear in more general terms. Nonetheless, the relevance of this experience surfaces when he speaks of "restriction of coinage or by promoting or restricting the efficacy of money-substituting institutions", and also of "strictly guaranteed limitation" of

[53] Schumpeter 1970, p. 78f; see also Schumpeter 1954, p. 1080.

state notes[54], where he evidently refers to the situation in Austria-Hungary between 1879 and 1892 when the money supply, consisting only of paper money remained more or less constant. More explicit references to constancy of the money supply appear in his 1892 article *Beiträge zur Währungsfrage*, where Menger approves of the decisions of the Austrian and the Hungarian governments to ensure constancy of the money supply by suspending the private coinage of silver in 1879[55], thereby establishing the conditions for "relative stability" of the value of the Austrian Guilder, "a characteristic which does not hold true either for gold or for silver money"[56].

In his contributions to the currency reform of 1892 Menger postulated a different goal for monetary policy: stability of purchasing power, i.e., constancy of outer value of money, when he cautioned against the risks of an inappropriately high gold content of the new currency. Negative effects on economic activity in general could be expected not only from a decrease of the value of money but also from an increase. When he pointed to the "pernicious consequences for our commerce and for the whole economy money would necessarily have if its purchasing power would rise from year to year and from decade to decade and change all obligatory relations accordingly"[57], he was referring to the experience of the long period of declining prices which had barely come to an and in 1892. In the ensuing decade the overall price level remained unchanged, followed by a period of increasing prices until World War I.

It appears that Menger was not aware of the inconsistency between the two goals. Of his followers, Wieser eventually opted form constancy of purchasing, whereas Hayek, postulating "neutrality of money", pleaded for keeping the money supply constant, and for accepting deflation as a consequence. Mises kept Menger's distinction between causes on the side of goods and on the side of money, while, at the same time, he distanced himself cautiously from Menger's terminology of inner and outer value[58].

Ad (ii) The implications for economic policy of Menger's theory of money, considered in its full complexity, are by no means as clear cut as they appear from the interpretations of later generations (from the 3rd generation onwards) of the Austrian School. Menger must have felt

[54] Menger 1909, p. 105.
[55] Menger 1892a, p. 140.
[56] Ibidem, p. 174
[57] Menger 1892a, p.156; see also Menger 1892c, p. 257
[58] For references and more details see Chaloupek 2021, p. 34ffd.

the tension between his adherence to the fundamental principles of political and economic liberalism on the one hand, and some conclusions of his theoretical analysis, from which suggestions for an active role of the state in the economy in certain matters could be derived.

Knowledge among today's economists of Carl Menger's theory of money is mostly confined to his description of the origins of money, with the emergence of the monetary system as a product of the spontaneous forces of evolution: "Money ... arises out of the self-interested actions of individuals ... as an unintended by-product of human action, it is not a creation of government."[59] But there are two other elements of Menger's theory of money, which are of high significance for theory as well as for economic policy, to which only little attention is paid today: his concept of inner value of money, and his discussion of the task of monetary policy to reduce uncertainty which prevails in an advanced capitalist economy, including the consequences for the quantity theory.

Menger's intensive search for clarification of the concept of inner value is not only, perhaps not even primarily driven by theoretical interests. For him, the theoretical problem is of great practical significance. Constancy of inner value is both an analytical concept and a political postulate. If realized in practice, it would free economic agents of money illusion which exerts a distorting influence on their decisions. If a realization of this goal does not seem out of reach, it would not be possible without increasing the power of the state over the economy through the institution which is in control of the quantities of money brought to the market, and which has the power to regulate the quantity "by restriction of coinage or by promoting or restricting the efficacy of money-substituting institutions", i.e., banks[60]. "Practical difficulties and dangers which the realization of these considerations would face cannot be overlooked". In the final version of the *Geld*-article this sentence is followed by a passage which cautions against the risks of such an enhancement of state power: "At present, fluctuations in world market prices of the precious metals seem to me to involve still lesser dangers than regulation of the inner value of money by governments or social or political parties". This passage, which appears to disrupt the flow of the argument, was inserted into the text of the original version of the article in the 1892 edition of the *Handwörterbuch*[61]. Obviously, Menger had become more cautious with respect to difficulties and dangers. Menger appears to be torn

[59] Vaughn 1987, p. 411
[60] Menger 1909, p. 86.
[61] See Menger 1892d, p. 750

back and forth between his ideal goal of monetary policy and liberal principles. But in the end his answer in 1909 is still affirmative: “It appears to me, that the search for a stable standard ... involves a problem whose solution is just a question of progress in scientific knowledge and whose solution in practice, to which the world economy might eventually be forced (which would not require absolute exactness, but only a degree of exactness sufficient for practical purposes), does not presuppose unattainable conditions.”[62] Hence, increasing state power was acceptable for Menger if it was capable of improving the functioning of the economy.

In his statements before the enquete commission on the controversial issue of the gold content of the new currency, Menger’s main concern was fear of deflation, if the Crown would be made too heavy. He pleaded for constancy of purchasing power: money serves its function best if it is protected against an increase as well as a decrease of its value.[63] Taking into account that, in 1892, the period of declining price level had hardly come to an end, and that the price of gold showed an upward trend, in this situation monetary stability meant for Menger that all influences should be neutralized which would force prices to fall. This implies a rather active role for the monetary policy of the state and its national bank to preserve the constancy of money’s intrinsic value.

A similar tension characterizes Menger’s discussion of the consequences resulting from his “monetary theory under uncertainty”. In this respect, “Menger anticipated most of Keynes’ ideas. Or, to be more precise, he had moved in the same direction of Keynes, long before Keynes, but more decisively and radically. Furthermore, hardly an author can be found ... who is so much the exact antipode of Milton Friedman, ... in spite of the fact that Manger and Friedman were of the same political persuasion.” If “Keynes’ liquidity is a matter of behaviour in security markets, ... Menger has a much more general theory of liquidity”.[64] As a consequence, the theoretical potential of the demand for liquidity to disturb the functioning of the whole economy appears considerably greater in Menger’s than in Keynes’ theory. But Menger seems less concerned about the question to what extent the theoretical potential implies imminent threat for the stability of the economy. To be sure, Austria’s political, economic and monetary history of the 19th century offered numerous examples for the

[62] Menger 1909, p. 87
[63] Menger 1892b, p. 207
[64] Streissler 1973, p. 165

relevance of such concerns. On the other hand, in the last quarter of the century Austria had regained a considerable degree of stability which allowed for a less pessimistic view. As Menger's testimony before the enquete commission shows, he was still concerned about the Austria's weak position on international financial markets, from which it depended all the more through its need to raise the capital necessary for the planned purchases of gold, with unexpected backflows of bonds, resulting in outflows of money. In this context, Menger saw a great responsibility for the A-HB to be ready for intervention "to act as precaution of the people" and to "settle the international balance in circumstances where the private economy could achieve this only by accepting great sacrifices."

Recurrent fluctuations in the demand for money in the course of cyclical movement of the economy should not, in Menger's view, be seen as result of changes in the velocity of circulation, but rather as a consequence of the use of hitherto inactive reserves for current payments.[65] Menger relies on the "elasticity of note issue", through which "the banks of issue perform the important function of adapting the monetary circulation to the economy's varying requirement for circulating media."[66] Menger's attitude towards paper money is friendly, he considers the effects of cash-economizing institutions as generally beneficial. Apparently, in the controversy between the Currency School and the Banking School his place is on the side of Thomas Tooke, as he does not mention any need for imposing restrictions on the issue of paper money as stipulated by the British Bank Act of 1844. Although Menger criticized the malfunctioning of state paper money in the Habsburg monarchy in the long period after suspension of payment in specie in 1848, he admits for the possibility of "state treasury notes circulating side by side with the national coin (because of their assured redemption or **their strictly guaranteed limited amount**)."[67] Another reason for Menger's paper money-friendly attitude lies in his concerns about deflation as a consequence of increasing scarcity of gold, which could be compensated by the issue of paper money.

Menger's positive attitude towards paper money becomes most evident from a statement made in the enquete commission, in which he emphasized that bank money (*Zettelbanken*) "had a function essentially different from that of 20 or 30 years ago", when "redeemability of notes" was the major concern. "This idea does not dominate (economic) science anymore."[68]

[65] P. 111
[66] p. 113
[67] p. 105
[68] Menger 1892c, p. 250

It has been pointed out by Y. Ikeda and other scholars[69] that, if Menger had convincingly described and explained the emergence of money in history as an "automatic" process, driven by spontaneous forces, he did not imply that this would apply to the monetary system at any stage of its development. Already the caption of subsection V of his article "The perfection of the monetary and coinage system by the state" suggests the contrary. In all modern states of ("civilized countries") the task of "supplying the economy with reliably minted coins" is performed "only by the state or under state supervision." Only the state can guarantee the uniformity of a country's monetary system, which is essential for providing

> "the foundation and prerequisite for a highly simplified and secure system of calculation and payments, a medium of exchange that, in contrast to the multiform money that developed automatically, is largely perfected and fungible within the limits of technical feasibility and especially prevents, in various ways, doubts and controversies over the legal objects of money debts."[70]

In his manner of meticulously looking into the difficulties and complexities of each matter, Menger takes great care in pointing to the inevitable imperfections of a "uniform" monetary system, resulting, e.g., loss of weight of coins due to frequent usage, remaining small differences in actual metal content due to mixture of different metals (gold and silver). In this context he also mentions "that frequently ... generally used means of payments of other kinds (bank notes, state treasury notes, foreign coins) come into circulation", which cannot be avoided, but "remedied only by a system of measures of the state", which "belong not only to the sphere of coinage policy but also to that of private law", etc.[71] [72]

It remains a puzzle why Menger devoted so much attention to such minor complications, while at the same time he did not discuss paper money as a general phenomenon with any comparable effort. In the context of establishing constancy of the inner Value of money he

[69] Ikeda 2008, Hodgson 2001.
[70] Menger 1909, p. 43. In his *Investigations* Menger mentions "Law" as another example of social institutions which, after having emerged as a result of spontaneous forces, are taken under state control at a later stage of development. (Menger 1985/1881, p. 223f)
[71] Ibidem, p. 44f.
[72] There is a parallel for Menger's argument about an institution whose evolution originates from spontaneous forces, but from some point onwards transform into co-evolution driven by market and state, in his comments on the formation of cartels and their official sanctioning through special laws. The movement towards cartelization was a dominant feature of industry in Germany and Austria in the decades before World War I. Austria was the first country on the continent to pass a cartel law in 1897. Menger emphasizes that cartels "have arisen from the needs of industrial and commercial businesses. They are a correlate of the structure of today's economy." Menger hopes that remedies against detrimental effects of cartelization might come from within the movement, while state regulations (via cartel legislation) "will not go beyond formal organization of associations and preventive measures against abuse of import duties for cartel purposes." (Menger 1905, p. VIIf)

refers to the need to use the "power of the state" to regulate the "the expansion or limitation of money substituting institutions", but the reader looks in vain for a more thorough discussion of the matter[73]. This is all the more remarkable, as paper money was by far more popular in Austria than the gold coins issued after the currency reform, which flowed back to the national bank in large part. If paper money, on the one hand, was well acceptable for Menger as product of spontaneous forces ("automatic" developments), he must have been aware, on the other side, that its more and more widespread use for all kinds of economic transactions brings with it a growing necessity for regulation by state agencies in the national and in the international context. The necessity for such state interference would emerge if excessive issue of paper money by the banking system became the cause of a rise of the general price level. One might surmise that Menger was willing to accept this development as necessary further perfection of the monetary system.

***

Summarized in brief, my conclusions are the following:

(i) Menger's theory of money is not "incomplete"[74], it is inconsistent with respect to the different concepts of value, and interwoven with ambivalences.

(ii) In his writings in the theory of money, especially with respect to his positions on monetary policy, Menger does not appear as rigorous defender of pure laissez faire. [75]

Menger's, ambitions did not go as far as proposing an overall model of a social order – this was the task which the members of later generations of the Austrian School set themselves, especially Ludwig Mises and F.A. Hayek. In the sphere of money, their claim, that – not in particular details, but in essence - Menger's theoretical approach suggested "a more radical appreciation of free markets" with respect to policy (Kirzner 1990, p. 93), implies that "spontaneous forces" should be given the greatest possible leeway in the development of the organization of the monetary system. But Menger did not intend to make a general claim for his theory of money as a product of spontaneous evolutionary forces as policy predicament for the sphere of money. He was quite explicit that the monetary system in an advanced capitalist market economy has to be regulated by the state, which has to exert control over the

[73] In his statements before the enquete commission Menger emphasizes that the function of paper money issuing banks has changed considerably, compared to 20 or 30 years ago. Greater transparency has minimized the risk of bank runs, while banks now play an important role as "regulators of international monetary relations." (Menger 1892c, p. 250)

[74] Salerno et al (2020), p. 702.

[75] Such claims regarding Menger have be denied in general by Böhm (1985)

sphere of money through detailed regulations. This finding finds its parallel in Menger’s position on other issues of economic and social policy, in which he advocated state interventions into the market process.

References

Böhm, Stephan, 1985; The political economy of the Austrian School, in: Roggi, P. (ed.), Gli economisti e la politica economica, Edizione Scientifiche Italiane, Naples

Campagnolo, Gilles, 2005; Carl Menger's "Money as a Measure of Value": An Introduction, in: History of Political Economy 37(2005), p. 233-244

Chaloupek, Günther, 2021;Carl Menger's different concepts of the value of money – the enigma of "the inner value of money", in: Research in the History of Economic Thought and Methodology: Including A Symposium on Carl Menger at the Centenary of His Death, Volume 39B, p. 23–42

Fellner, Friedrich, 1911; Die Währungsreform in Ungarn mit besonderer Rücksicht auf die Aufnahme der Barzahlungen, Wien

Hodgson, Geoffrey, 2001; How Economics Forgot History, Routledge, London

Ikeda, Yukihiro, 2008; Carl Menger's monetary theory: A revisionist view, in The European Journal of the History of Economic Thought 15(2008), p. 455-473

Kindleberger, Charles P., 1984, A financial history of Western Europe, London, Allen & Unwin

Kirzner, Israel, 1990; Menger, classical liberalism, and the Austrian School of economics, in: Caldwell, B.J. (ed.), Carl Menger and his legacy in economics. History of Political economy XXII Annual supplement, p. 93-106

Jankovich, Bela von, Index-number von 45 Waren in der österreichischen Monarchie (1867-1909), in: Bulletin de l'Institut International de Statistique 19/3, Den Haag 1913, pp. 120ff

Kamitz, Reinhard, 1949; Die österreichischen Geld- und Währungspolitik 1848-1948, in: H. Mayer (ed.), Hundert Jahre österreichischer Wirtschaftsentwicklung. Vienna, pp. 127-221

Latzer, Michael/Schmitz, Stephan W. (eds.), 2002; Carl Menger and the Evolution of Payment Systems. Edward Elgar, Cheltenham, U.K.

März, Eduard/Socher, Karl, 1973; Währung und Banken in Cisleithanien, in: A.Brusatti (ed.), Die Habsburgermonarchie 1848-1918, Vol. 1: Die wirtschaftliche Entwicklung. Vienna, pp. 323-368

Mataja, Victor, 1893; Die österreichische Währungs-Enquete, in: Zeitschrift für Volkswirtschaft, Sozialpolitik und Verwaltung I (1893)

Menger, Carl, 1892a; Beiträge zur Währungsfrage, in: Menger, Carl, Gesammelte Werke, Vol. IV, pp.125-187

Menger, Carl, 1892b; Der Übergang zur Goldwährung, in: Menger, Carl, Gesammelte Werke, Vol. IV, pp.189-224

Menger, Carl, 1892c; Aussagen in der Valutaenquete, in: Menger, Carl, Gesammelte Werke, Vol. IV, pp. 225-286

Menger, Carl, 1892d; Geld, in: Handwörterbuch der Staatswissenschaften, Dritter Band, ed, J. Conrad et al., Gustav Fischer Verlag, Jena, p. 730-757

Menger, Carl, 1893; Das Goldagio und der heutige Stand der Valutareform, in: Menger, Carl, Gesammelte Werke, Vol. IV, pp. 308-324

Menger, Carl, 1895; Geld- und Münzwesen, in: Österreichisches Staatswörterbuch, eds. E. Mischler and J. Ulbrich, Erster Band, Alfred Hölder, Wien 1895, p. 665-671

Menger, Carl, 1905; Vorwort zu: Ettinger, Markus, Die Regelung des Wettbewerbs im modernen Wirtschaftssystem, Wien, p. V-VIII

Menger, Carl, 1909; Geld, in: Menger, Carl, Gesammelte Werke, Vol. IV, pp.1-124; English translation by L.B. Yeager and M. Streissler, in: Latzer/Schmitz 2002, p. 11-107

Menger, Carl, 1909/2005; Money as a Measure of Value (1992), translated by Gilles Campagnolo, in: History of Political Economy 37(2005), p. 245 -261

Menger, Carl, 1970; Gesammelte Werke, Vol. IV (ed. F.A.Hayek), Tübingen

Menger, Carl, 1976/1871; Principles of Economics, Libertarian Press, Grove City, PA, translation from the German original Grundsätze der Volkswirtschaftslehre (1871)

Menger, Carl, 1985/1881; Investigations into the Method of the Social Sciences with Special Reference to Economics, New York University Press, New York and London, translation from the German original Untersuchungen über die Methode der Socialwissenschaften, und der politischen Oekonomie insbesondere (1883)

Mises, Ludwig, 1924; Theorie des Geldes und der Umlaufsmittel, 2. Auflage, Duncker & Humblot, München und Leipzig

Mühlpeck, Vera/Sandgruber, Roman/Woitek, Hannelore, 1979; Index der Verbraucherpreise, in: Geschichte und Ergebnisse der zentralen amtlichen Statistik in Österreich 1829-1979, Wien

Salerno, Joseph T./Dorobat, Carmen Elena/Israel, Karl.Friedrich, Two views on neutral money; Wieser and Hayek versus Menger and Mises, in: The European Journal of the History of Economic Thought 20(2020), p. 682-711

Schumpeter, Joseph A., 1954; History of Economic Analysis, Allen & Unwin, London-Boston-Sydney

Schumpeter, Joseph. A., 1970; Das Wesen des Geldes, ed. F.K. Mann, Verlag Vandenhoeck & Ruprecht, Göttingen 1970

Streissler, Erich, 1973; Menger’s Theories of Money and Uncertainty – a Modern Interpretation, in: J.R.Hicks/W.Weber, Carl Menger and the Austrian School of Economics. Oxford 1973, pp. 164-189

Streissler, Erich, 2002; Carl Menger's article „Money“ in the history of economic thought, in: Latzer/Schmitz 2002, p. 11-24

Vaughn, Karen I., 1987; article “Menger, Carl” in: The New Palgrave, ed. J. Eatwell, Macnillian, London, Vol. 3, p. 438-444

Wieser, Friedrich, 1893; Die Wiederaufnahme der Barzahlungen in Österreich-Ungarn, in: Wieser, Friedrich, Gesammelte Abhandlungen (ed. F.A. Hayek), Tübingen 1929, pp. 253-277; first published in English in: Journal of Political Economy 1(1893)

Wieser, Friedrich, 1894; Die Währungsfrage und die Zukunft der österreichisch-ungarischen Valutareform. Vortrag gehalten am 22.Jänner 1894 im Prager deutschen kaufmännischen Vereine. Prag Wien Leipzig 1894

Wieser, Friedrich, 1909; Der Geldwert und seine Veränderungen, in: Wieser, Friedrich, Gesammelte Abhandlungen (ed. F.A. Hayek), Tübingen 1929, pp.193-242

Wieser, Friedrich, 1926; Artikel „Geld - I. Theorie des Geldes“, in: Handwörterbuch der Staatswissenschaften, 4th edition, Vol. 5, p. 681-717

Wirth, Max, 1894; Die Notenbank-Frage in Beziehung zur Währungsreform in Österreich-Ungarn. Frankfurt 1894