

It isn't capitalism that has caused the crisis!

written by Edward Maas | April 23, 2013

THE MATTERHORN INTERVIEW – APRIL 2013: Thorsten Polleit

“It isn't capitalism that has caused the crisis!”

The financial journalist Lars Schall talked for Matterhorn Asset Management with seasoned investment banker and renowned economist Prof Thorsten Polleit whether the financial system can adjust by itself, whether central banks are needed or not, and whether the gold market is a free market at all. Moreover, Prof Polleit gives his answer to the question: **what is good money?**

By Lars Schall



Thorsten Polleit, born 1967, is Chief Economist of Degussa Goldhandel GmbH (established in Frankfurt, Germany in 1843) and a member of the firm's advisory board (www.degussa-goldhandel.de). In the period of October 2000 to April 2012, he worked as Chief German Economist for Barclays Capital, focusing on European economic and political developments. Before that, he worked as Chief German Economist for ABN AMRO in London, Amsterdam and Frankfurt.

L.S.: Is the economic and financial crisis the consequence of the failure of capitalism?

T.P.: This is perhaps the most important question that needs to be raised, and hardly anyone is raising it. So I am most pleased with the opportunity to provide a proper answer. Let me give it to you straight: No, it isn't capitalism that has caused the crisis. The world we are living isn't capitalism, as many people would like to make you believe. We live in a world of interventionism: that is government interfering in the market, violating peoples' property rights, thereby providing people with incentives to do bad things. This is what has brought about all the trouble we face today. If we had true capitalism, we wouldn't have the current problems, to be sure.

L.S.: However, do we see a failure of the science and profession of economics?

T.P.: Under the dominance of state education – from Kindergarten to university –, economics has actually become, first and foremost, a pseudo-science legitimizing government interventionism in virtually all walks of life. So my answer to your question would be yes, I am afraid.

L.S.: Which causes do you see for the crisis?

I know it has become quite fashionable among economists to mention all sorts of causes: such as a lack of regulation, manager greed, insufficient policy coordination and so on. However, I see just one cause: and that is societies having fallen victim to paper, or fiat, money. Of course, you may explain the latter by blaming, say, the welfare-warfare state, majority voting etc. Fair enough. But I would think that if people understand paper money as the root cause of the current problems, we would be a great deal nearer to a solution to these problems.

L.S.: Can the system adjust by itself?

T.P.: Sound economic theory – and that is the Austrian School of Economics – would tell you NO. The fiat money system cannot adjust itself back to equilibrium. For fiat money causes, and necessarily so, economic disequilibria. Central banks slashing interest rates, pumping up the money supply, running deficits etc., wouldn't unwind any disequilibrium. On the contrary. Any such measures would make them even worse.

L.S.: What do you think about bank bailouts?

T.P.: I guess I very much understand those advocating bank bailouts as a means for avoiding a recession-depression. However, as an economist in the Austrian tradition I must say that bank bailouts will not cure the crisis but will make it even worse. Government interference in the market place may mask the real economic problems, it may postpone the true outbreak of the crisis, but this comes at a high price, namely an even bigger crisis in the future. We won't escape the damage caused by having used fiat money.

L.S.: Are the rescue measures in the euro crisis more or less just another bailout of banks, in this case predominantly German and French banks?

T.P.: The banking system operates on fractional reserves, and that makes it vulnerable to bank runs. Bailing out one bank is therefore benefitting all other banks, as investors typically assume that central banks will provide a safety net for all banks. That said, having bailed out Greece, Irish, Portuguese and Spanish banks means of course helping Italian, French and German banks.

L.S.: Does the world need central banks?

T.P.: Money has emerged spontaneously out of the free market. It is a free market phenomenon. This is a theory put forward by the economist Carl Menger (1840 – 1921). That said, you wouldn't need any government, or any central banks for that matter, for getting sound money. In fact, the opposite is true: government replaces unsound money for sound money. Indeed, the world over central banks have been created by governments to destroy free market

money and give government full control of society's monetary affairs. Central banks serve a few at the expense of the great majority of the people. So, no, we do not need central banks.

L.S.: Why do central banks have to set interest rates in the first place? Isn't that something a free market place can do?

T.P.: In a fiat money system, money is produced through bank credit expansion. On the one hand, this is a fairly profitable business for the fiat money producer – that is for government and the banking industry. On the other hand, controlling the interest rate offers money producers and their beneficiaries a strong grip on the economy, that is it offers power on a grandest scale. This is why central banks (and their beneficiaries) want to set interest in the first place.

L.S.: What do you think about the LIBOR scandal?

T.P.: If the public was somewhat better informed, it would realize that the interest rate scandal that really matters is what central banks' manipulation of market interest rates. By doing so, central banks not only cause economic problems on the grandest scale, but also enriching some at the expense many others. You may want to dig into what happened in the calculation of Libor. But this issue is really dwarfed by the evils caused by central banks manipulating market rates.

L.S.: Do you think the world of fiat money will go under?

T.P.: Well, what do you mean by "going under"? Do you mean that fiat money's purchasing power will decline by, say, 90%? Or do you mean that fiat money will be destroyed as it happened in 1923? In both cases you could very well say that fiat money has gone under Now, this is what I think: Fiat currencies will be heavily debased, and some of them will go under.

L.S.: You're an advocate of "free banking" with private money. What's that?

T.P.: It basically means: leave monetary issues to the free market, like the shoe business, the car business, or the fashion business. Get government out of the money business, and let the free market decide what kind of money people would like to hold. Don't limit peoples' choices. Don't restrict people in supplying money. Don't provide certain people with government granted privileges. The free choice of currency is accompanied with entrepreneurs being free to enter and exit the money warehouse business and the credit business.

L.S.: What are the advantages of such a system?

T.P.: To answer this question we have to talk about the advantages of free banking over the current arrangement, that is a government sponsored fiat money regime. In a true free banking system, you wouldn't have chronically inflationary money. You wouldn't have money that benefits a few at the expense of many others. You wouldn't have boom-and/bust cycles, which are so harmful for societies. And you would have the yoke of eventual over-indebtedness, with all its economic and political problems.

L.S.: What's good money?

T.P.: Good money is money produced in the free market, money that is produced in full compliance with the principles of the free market. The latter basically means unconditional compliance with individual property rights. That said, good money means that money holders are free to decide which kind of money they would like to hold. It also means that there is full freedom of the suppliers of money to offer their monies. It is the demand for money that decides what will be money.

L.S.: Is gold money?

T.P.: I would say so, gold is indeed the ultimate means of payment.

L.S.: Is the gold market a free market?

T.P.: A free market means that there is a free supply of and a free demand for gold, that determines its purchasing power. However, government sponsored central banks also play a role in affecting the supply of and demand for gold through, for instance, lease transactions. In that sense market conditions are influenced, and at times greatly so, by government interference – and therefore do not correspond with the principles guiding a free market.

L.S.: What do you see as the end scenario for the euro?

T.P.: Well, one could image several “end scenarios” for the euro. In the “end scenario” euro denominated savings deposits and bonds denominated in euro might become worthless, I am afraid, be it because of ECB embarks upon money printing, be it because of a currency reform, or because of a disorderly blow up of the single currency area.

L.S.: Thank you very much for taking your time, Prof Polleit!

INFORMATION: Thorsten Polleit holds a diploma in economics and was awarded a doctorate in 1996 at the University of Muenster, Germany. In 2000, he founded “ECB Observer,” an independent ECB watcher group (www.ecb-observer.com). He is also a co-founder of the research network “Research on Money in the Economy (ROME)” (<http://www.rome-net.org/html/home.html>), and co-founder / partner of Polleit & Riechert Investment Management LLP (<http://www.polleit-rieichert.com/>). In 2003, he was appointed Professor for Economics at the Frankfurt School of Finance & Management. He also lectures at the universities of Duisburg-Essen and Bayreuth. Moreover, he is an Adjunct Scholar at the Ludwig von Mises Institute in Auburn, Alabama, USA.

His latest books are “Monetary Economics in Global Financial Markets” (2009, co-authored with Prof. Dr. Ansgar Belke) and “Geldreform” (2010, co-authored with Dr. Michael von Prollius). His research interests are monetary economics, capital market theory, and the Austrian School of Economics. A publication list can be found at his personal web site here: <http://www.thorsten-polleit.com/>.

Matterhorn Asset Management is dedicated to wealth preservation through safe and secure silver and gold storage in Switzerland. Protect your gold in the world's safest vaults. To become a client, [click here](#).