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(English version)

IN OUR TIME



FINANCIAL CRISIS, BANKING REFORM AND THE FUTURE OF CAPITALISM

JESÚS HUERTA DE SOTO

ABOUT THE AUTHOR



Jesús Huerta de Soto is Professor of Political Economy at Rey Juan Carlos University in Madrid. He holds a PhD in Law and a PhD in Economics from Complutense University of Madrid and a Master of Business Administration from Stanford University. Author of twelve books published in more than sixty editions worldwide and translated into nearly twenty languages, Professor Huerta de Soto is one of the leading figures in the Austrian School of Economics today. His extensive academic career has earned him distinctions such as honorary doctorates from Francisco Marroquín University (Guatemala), Alexandru Ioan Cuza University (Iasi, Romania), Moscow Financial University (Russia), ESEADE (Argentina), and National University of San Marcos (Lima, Peru). He edits the journal *Procesos de Mercado* and, through his presence in the media and at events and projects of an informative nature, is today one of the most recognized voices in the field and ideas of Liberty.

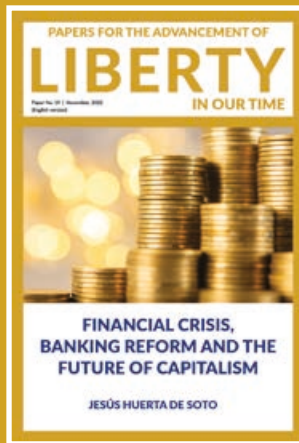
FINANCIAL CRISIS, BANKING REFORM AND THE FUTURE OF CAPITALISM*

JESÚS HUERTA DE SOTO

KEYNOTE SPEECH
DELIVERED ON APRIL 19, 2012
AT THE RAFAEL DEL PINO FOUNDATION
(MADRID)

* AUTHOR'S NOTE. This lecture was never written or read, so what is reproduced in the text is a literal transcription of what was "improvised" on that occasion. I therefore trust in the reader's benevolence and hope that what has been lost in precision is more than compensated for in liveliness, clarity, and entertainment value. On the other hand, it should be noted that, as of the date of publication of this Notebook, the lecture, which lasted more than an hour and a half, has already been viewed by some 200,000 people on YouTube.

EDITOR'S NOTE: The full lecture, its presentation by Ms. María del Pino, and the subsequent discussion are transcribed here.



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María del Pino:

Good afternoon, everyone. Welcome to this new lecture in the Foundation's lecture series. Today we are joined by Jesús Huerta de Soto, so this is a very special day for me. Jesús and I were, I say this with all humility, classmates. From the very beginning, Jesús was a brilliant student. I think he had read all the books for the degree program during high school. In fact, they should have awarded him the degree on the first day. We were all impressed by how much he knew, and he even put more than one professor in a tight spot with his famous quotes in English. The truth is that he was the joy of the class, and we were all very proud because he raised the bar; although not all the professors wanted to teach us because they were afraid of him. I believe that every class in the world should have a Jesús Huerta de Soto to push the rest of the students. Welcome, Jesús. It is an honor for the Foundation to have you here today.

Professor Huerta de Soto is undoubtedly one of the most authoritative voices of liberal thought in the world, and his proposals, based on his profound knowledge of the contributions of the Austrian School of economic thought, leave no one indifferent. He is a great connoisseur and defender of the Hispanic origins of economic science, one of his most productive fields of research. The high level of interest in this lecture and the large number of confirmations has even forced us to open the adjoining rooms of the main building.

Thank you very much to everyone. To those of you who have not been able to enter this auditorium, thank you for your interest and understanding. A special greeting to those who follow us on social media, especially on Twitter.

Jesús Huerta de Soto was born in Madrid in 1956 and holds a PhD in Economics and Law from the Complutense University of Madrid, *graduating with honors* and receiving a special award at the end of his studies. At the young age of 26 received the King Juan Carlos International Economics Prize for his study on the privatization of pensions in Spain. He also holds a degree in mathematical actuarial science from the Complutense University of Madrid and an MBA from Stanford University, where he studied political economy with a scholarship from the Bank of Spain.

Professor Huerta de Soto is currently a professor of political economy at the Rey Juan Carlos University in Madrid. His indisputable talent and academic and research enthusiasm have encouraged the flourishing of a large group of young researchers who have highlighted the legacy of great thinkers and economists such as Carl Menger, Eugen Böhm-Bawerk, Ludwig von Mises—about whom he will speak in more detail later—and others. Throughout his prolific teaching and research career, he has received numerous awards, including the Adam Smith Prize, awarded by the Center for the New Europe in Brussels, the Franz Cuhel Memorial Prize for excellence in the teaching of economics, awarded by the University of

María del Pino: “Jesús Huerta de Soto is the most cited Spanish economics professor on the internet, with more than 1,250,000 citations and references. The video edition of his university courses is followed by hundreds of thousands of people.”

Prague, and many others. Jesús Huerta de Soto holds honorary doctorates in social sciences from Francisco Marroquín University and in economics from Alexandru Ioan Cuza University in Iasi (Romania) and the Financial University under the Government of the Russian Federation in Moscow. He is a member of the Mont Pèlerin Society, as well as the Royal Society of London and the American Economic Association. He is also a patron of the Madrid Institute for Advanced Studies in the Social Sciences Foundation, founder and director of the scientific journal *Procesos de Mercado*, and Spanish editor of Hayek's complete works, as well as the 44 volumes published in Unión Editorial's *Nueva Biblioteca de la Libertad* series.

Professor Huerta de Soto is the author of numerous works and research articles on topics related to his field of expertise. Among them are: *Planes de pensiones privados; Lecturas de Economía*

política; Socialism, Economic Calculation, and Entrepreneurship; Estudios de Economía Política; Money, Bank Credit, and Economic Cycles; The Austrian School: Market and Entrepreneurial Creativity; New Studies in Political Economy; Ahorro y previsión en el seguro de vida y otros ensayos sobre seguridad social y planes de pensiones; The Theory of Dynamic Efficiency. He is also co-author, together with Alejandro García and other authors, of *the Libro Blanco sobre el papel del Estado en la economía española*, edited by Rafael Termes and published in 1996 by the Instituto Superior de Estudios Empresariales.

Jesús Huerta de Soto has published 42 articles in scientific journals on economics and social sciences, as well as 24 chapters in other collective works. He has supervised 16 doctoral theses and the video edition of his university courses, which have been followed by more than 67,000 students



Presentation of the keynote speech. Madrid, April 19, 2022.

I would venture to say that all the problems affecting us today can be traced back to something that happened in the United Kingdom on July 19, 1844. That was the day the Peel Banking Act was passed.

on the Juan de Mariana Institute website. It should be noted that some of his classes, such as the one on the fall of the Roman Empire, have been viewed on YouTube by more than 380,000 people. All of this has made Jesús Huerta de Soto the most cited Spanish professor of economics on the internet, with more than 1,250,000 citations and references, according to the most reliable analysts and search engines on the web.

Jesús, welcome. Thank you very much for being here, and thank you, Sonsoles, for joining us as well. Don Jesús, you have the floor.

Jesús Huerta de Soto:

Many thanks to our president, María del Pino, whom I met 38 years ago. Don't speculate about her age because I think she was given special permission to go to university when she was four or five years old. Many thanks also to the del Pino Foundation. I would also like to thank the director of the Foundation, Amadeo Petitbò, for inviting me.

The origin of this lecture lies in a second review I did of Mises' *Theory of Money and Credit*, which we have just published to celebrate the centenary of the book's publication. Although it was first published in 1912, it is still highly relevant today. In fact, everything I am going to say here today, in one way or another, is inspired by the work of the great Mises. That is why I believe it is only fair that we dedicate today's lesson to Ludwig von Mises. With that said, let's begin.

We cannot be frivolous: we are in a very deep economic recession; there are more than five million unemployed in our country and one and a half million families with almost all their members unemployed. Because of this, what we are going to study today is of essential importance.

I would dare to say that all the problems that affect us, all the economic suffering we endure, have their origin in something that happened in the United Kingdom on July 19, 1844. What happened on that fateful day? Very simple: on that day, the Peel Banking Act was passed and enacted. This law was, in a way, the culmination of decades of debate between two schools of economic thought, both of which sought to explain why England, since the beginning of the Industrial Revolution, had been affected by recurring cycles of speculative bubbles, financial crises, and economic recession.

On one side was the Banking School and on the other was the Monetary School. I can tell you right now that the Monetary School was right: only they were able to accurately diagnose many of the causes of these recurring cycles of bubbles and recession. They attributed these cycles to a curious phenomenon affecting the banking system of the time, specifically the business carried out by private bankers in England at the time, which basically consisted of issuing paper money, banknotes, without being 100% backed by real money (at that time, gold).

This is a curious business, which developed after the creation of the Bank of Stockholm in

1656. It is easy to understand: bankers initially act legitimately and, in exchange for the gold deposited with them, they issue a receipt certifying the money that has been given to them on deposit. As bank customers trusted in their solvency and that they would take good care of those deposits, they began to accept and use not the gold itself as a means of payment, but the receipts. Then, some bankers who were more "savvy" than the rest realized this phenomenon and began to be tempted to issue more receipts than the gold originally deposited.

Theorists of the Monetary School realized that this initially had a bubble effect, because what the banking system was doing was issuing more paper money than the gold originally deposited, and this impacted the economic system by creating a bubble: there was a greater money supply and prices rose, which generated a feeling of

euphoria that we will discuss later. The problem is that in the long run, a counteracting effect occurred, as prices began to rise in England and, in relative terms, it became cheaper to buy goods and services on the continent, across the Channel. At that point, imports increased, exports decreased, and French or German sellers demanded gold and withdrew it from the banks, causing them to lose their reserves and immediately triggering the first financial crises. These were precisely the phenomena explained by the theorists of the Monetary School.

The Peel Act was, in a way, the legislative embodiment of the triumph of the Monetary School theorists, because that law established that it was prohibited to issue receipts in excess of the volume of gold originally deposited in the bank. In other words, it established a 100% cash reserve requirement in relation to the paper money issued



Sir Robert Peel.

Luis de Molina uses the term *chirographis pecuniarum*, or “scriptural money,” to refer to the money that banks create out of thin air, in the form of entries in their accounting books.

by banks. Incidentally, what Peel’s Act ultimately did was to give legal recognition to one of the essential principles of property law, which requires a market economy and a capitalist system to function: scrupulous respect, in the case of deposits, for the fulfillment of certificates that in some way justify the money that has been received. In fact, if someone issues more receipts than they have actually received, they are committing several crimes, starting with forgery of public documents and fraud.

Peel’s Act prohibited this from continuing and marked the triumph of the theorists of the Monetary School, as well as a legislative project, supported by the English people, in which great hope was placed that, from then on, England would be exempt from suffering those recurring cycles that, since the Napoleonic Wars and in the midst of the Industrial Revolution, had been affecting the United Kingdom.

However, despite the good intentions of the law, it was a huge failure. This is a tremendous thing, as it has been affecting the Western world ever since and continues to affect us today. Why was the Peel Act a failure? Very simple: because it failed to require the maintenance of a 100% cash ratio not only in relation to the issuance of paper money, but also in relation to another business that banks were engaged in, namely the issuance of demand deposits. This is something that many non-experts in economics, and even many experts, find difficult to understand. However, from an

economic point of view, there is no difference between issuing counterfeit receipts—that is, unbacked paper money—and issuing unbacked deposits. In fact, the accounting entry is practically the same.

The issuance of paper money is “money you create out of thin air and lend,” and the issuance of deposits is “deposits you create out of thin air and lend.” When Peel’s Act prohibited the continuation of the former business, private bankers simply redirected themselves toward the latter. They could no longer continue to issue paper money in excess of the gold they had received, so they switched to issuing demand deposits to grant loans. Why did the Peel Act fail to require 100% coverage for demand deposits as well? Simply because economic theorists were not clear that demand deposits are part of the money supply in the same way as cash—then gold and the corresponding banknotes.

This is a tragedy because almost three hundred years before this debate and this law, those great thinkers of our Golden Age, the scholastics of the University of Salamanca, had already discovered that demand deposits are part of the money supply. Specifically, Luis de Molina uses the term *chirographis pecuniarum*—scriptural money that banks generate out of thin air in the form of entries in their accounting books—and adds that exchange would not be possible, with such high prices, of the large quantity of goods that change hands at the Castilian fairs of Medina del Campo, Villalón,

and Medina de Rioseco, if it were not for this scriptural money, that is, for the demand deposits that bankers create out of thin air.

Our scholars added that bankers commit mortal sin when they do not maintain a cash ratio of 100% in relation to demand deposits (although here the crime is different: it is no longer a crime of falsification of a public document and fraud, but of misappropriation). Furthermore, they argued very forcefully that in any demand deposit of a fungible good—whether it be wheat in a silo, oil in an oil mill, or money in a bank—when the depositor responsible for its safekeeping and custody does not maintain at all times the equivalent in quantity and quality to what was originally deposited, they commit a crime of misappropriation.

If we take into account what happened, with all this background information, I think it will be relatively easy to understand, albeit in a nutshell,

how the entire financial and banking system has evolved from then until now. Despite its good intentions, the Peel Act was a Pyrrhic and unsuccessful victory. Banks, as I mentioned earlier, only changed the way they did business slightly, moving from issuing paper money to issuing deposits. What was the result of this? Recurring cycles of speculative bubbles, economic booms, financial crises, and recessions were not avoided.

All the prestige and public support that the Peel Act had enjoyed plummeted. Every few years, the bubbles recurred, and citizens did not understand what they had done wrong. It was then that it was insisted that the banks had to be saved by creating, at the request of the bankers themselves, a lender of last resort to bail out the bankers in times of trouble, which experience showed occurred regularly, time and time again. At first, the lender of last resort was the most important bank,



Luis de Molina.

The classic pure gold standard prevented the introduction of a purely fiat means of payment with the capacity to expand the money supply as much as necessary at any given time.

the Bank of England. In order for the Bank of England to ultimately save the private banks, it had to be able to create all the necessary liquidity out of thin air, and this posed a problem with regard to gold, as gold cannot be created out of thin air. How did they solve this problem? Very simply: through laws of legal tender, which made it compulsory to accept paper pounds issued by the central bank as a means of payment.

Let's look at the logic of events: the mistake made by the Peel Act, although it was well-intentioned; the need for a lender of last resort, which would eventually become the central bank; the introduction of a purely fiduciary media with the ability to expand the money supply as much as necessary at any given time; the latter was prevented by gold, which ultimately led to the abandonment of the classic pure gold standard. And so it continues today. It is incredible that in the 21st century we are still heirs to this historical accident.

Below, we will explain in a little more detail how this process of credit expansion without a real savings base, which originates in the injection of money in the form of deposits, impacts the real economy by inducing systematic errors in savings and investment that sooner or later manifest themselves in the form of a financial crisis, followed by an economic recession and finally a budget crisis. In other words, what I am going to do is explain the Austrian theory of the economic cycle. But first, I am going to explain the Capital Theory, that great forgotten theory, which in my

view is essential to know and master if one wants to understand anything about what is happening in the economy.

The theory of capital explains the bridge or connection between the monetary and real aspects of an economy, that is, how the driving force of money affects the temporal structure of the production process in the real economy.

To understand this, let's take the process of manufacturing a car as an example. According to Austrian theorists, every production process involves "time," which consists of a series of successive stages. As the economy advances, production processes are becoming longer in terms of time and, in turn, more productive: from the design of a specific car model to the decision to put it on sale, it goes through a series of stages such as the extraction of iron ore, its conversion into steel, assembly, marketing, and distribution. As can be seen, there are a series of successive stages that together can take years. Right now, the cars we will buy in seven or eight years' time are being designed. Therefore, understanding the production process as a series of stages helps us to understand many other things in economics.

The first is that most of the business, human, and worker effort is located not in the stages closest to consumption, but in the stages furthest from it. Another thing that is very easy to understand is why National Accounting is practically useless for tracking the cycle, since the figures for National Product or Gross Domestic Product only

include final consumer goods and capital goods that reach the end user, but do not take into account all the previous stages. In other words, the value of the ore that comes out of the mine, or that of the company that designs or manufactures carburetors, etc., is not included in GDP. In a way, approximately two-thirds of entrepreneurial effort and of the production factors, are eliminated from the calculation of Gross Domestic Product figures.

We will now explain how, in an unregulated market economy, there is an inexorable tendency for genuine savings to be invested appropriately, that is, in a sustainable manner in accordance with consumer preferences. In short, I will explain why the much-discussed Keynesian paradox of savings is false from a theoretical point of view.

If time preference suddenly declines and society decides, in general, to save more, three

extremely important microeconomic effects occur that tend to channel voluntary savings in a sustainable manner toward viable investments.

First, there is an effect of disparity in profits between the different stages of the production process. If we save more, we consume less, and this has a reducing effect on the monetary demand for consumer goods. In other words, it has a depressing effect on companies that sell consumer goods and services: their profits suffer and, in relative terms, become lower than those of companies operating in sectors that are further removed from consumption. This is an essential first microeconomic signal, because corporate profits are the basic market signal that tells entrepreneurs what they should or should not do. If there are fewer relative profits in immediate consumption (or even losses) and they remain in the stages furthest from consumption—those that are producing not for



Credit expansion through the injection of money in the form of deposits induces savings and investment errors that lead to a financial crisis, then an economic recession, and finally a budget crisis.

immediate consumption but for future consumption—such a disparity in profits leads entrepreneurs to redirect their investment; it is as if the market were telling them: “stop investing in immediate consumption and invest in investment projects that will mature in the more distant future.”

The second microeconomic effect has to do with interest rates, namely that an increase in savings, all other things being equal, comes from a decrease in the rate of time preference and causes a decrease in interest rates. The interest rate is an essential price in the market and, therefore, the one that should be the most free and the least manipulated: it is the price of present goods in relation to future goods, it is the key price that in some way allows intertemporal coordination between those who invest, those who save, and those who consume. However, it is tragic that it is the price most intervened and manipulated by politicians, governments, central banks, etc. The fall in interest rates that results from saving makes the present value of the future production stream of each capital good higher. This tends to raise the market price of capital goods, which is another essential signal that tells entrepreneurs how to redirect their investment efforts towards the production of capital goods.

We are left with a third micro effect, which Hayek calls the Ricardo Effect: the impact of increased savings on real wages. The concept is very simple: an increase in savings causes the prices of consumer goods to fall in relative terms.

If the prices of consumer goods fall and nominal wages remain the same, real wages are increasing. Thus, as labor becomes more expensive in relative terms, entrepreneurs begin to replace workers with capital equipment. Workers are laid off from the stages closest to consumption, which are precisely those that go on to produce the new capital goods that are in demand as a result of the Ricardo Effect.

As we can see, these three microeconomic effects all point in the same direction and ultimately consolidate a more capital-intensive productive structure, with more stages that mature in the more distant future. This is the healthiest economic growth process conceivable, because the more stages of capital goods an economy incorporates, the more productive it ends up being.

I believe that thanks to this brief introduction, it will be very easy for us to understand, by contrast and opposition, what happens when there is a process of credit expansion, that is, growth in the loans granted to entrepreneurs, but financed not with genuine prior savings, but through this process of money creation that was opened up after Peel's Act.

When the new money is received, entrepreneurs do not know whether it comes from genuine savings or is the result of credit expansion. Credit expansion during the bubble causes tremendous damage: it could be compared to a drug, because during the bubble we are all happy; any business project, no matter how crazy, can find financing.

It should be borne in mind that entrepreneurs can sometimes be like runaway horses: it is just as important to provide financing for viable projects as it is to withdraw it from crazy ones. But during the bubble stage, all projects seem viable.

Entrepreneurs and workers, however, are delighted that credit is flowing. Note that in the process of genuine saving, workers were freed from the stages closest to consumption when savings increased and were redirected to the stages furthest away. When the process originates in credit expansion, factors of production originating from nowhere are freed up (since savings have not increased), and then entrepreneurs, with the new purchasing power they have received from the banks, demand factors of production whose price skyrockets. The unions are delighted: any request that would normally seem crazy, given the need to push forward the bubble projects, ends up being

accepted by entrepreneurs. Merchants are delighted, especially those in the consumption stages. Politicians and civil servants are delighted: at this moment in the bubble, they score points, as they can say, “This is the result of my good economic policy, vote for me,” and the curious thing is that citizens believe them and vote for them.

In general, the whole of society settles into a feeling of euphoria. The message conveyed to society is that we can achieve whatever we want without the sacrifice of saving and disciplined effort. This destroys all the habits of effort, discipline, and work that a healthy society needs, that is, it generates a social disease.

How does this affect democracy? Democracy loses out because, during the bubble era, relentless credit expansion distorts politicians' views on, among other things, state budgets, allowing them to squander public money. However, when we



In an unfettered market economy, there is an inexorable tendency for savings to be invested appropriately, that is, to be invested in a sustainable manner in accordance with consumer preferences.

reach the recession stage, their eyes are opened to the economic reality of the nation and their position. I would venture to say that it is now, for the first time since the restoration of democracy, that politicians are beginning to be aware of the responsibilities that come with their position, which are none other than those of managing a limited budget.

But how long can the bubble last? If we asked this same question to Keynesians and monetarists—the same dogs but with different collars—their answer would be practically the same. For them, bubbles are normal in the economy: according to Keynesians, during this “normal” bubble stage, it sometimes happens that, for unknown reasons, entrepreneurs, who they believe to be manic-depressive, wake up one day and decide not to invest. Krugman, in his introduction to *Keynes’ General Theory*, says that “an economist should never ask, during a depression, what caused it,” and goes on to say that “what needs to be done in these circumstances is to spend more and inject more liquidity.” Monetarists, for their part, have Friedman’s *plucking model* theory, which argues that everything is fine and that bubbles are normal, but that from time to time there is a downturn, at which point it is time to do the *plucking*, in the form of a credit expansion hose. They are currently in control of the Federal Reserve and the Bank of England.

According to these theories, there is no need to analyze the causes of these downturns in acti-

vity, but are we sure there is no need to analyze the causes of crises? Because perhaps the cause of crises is precisely those injections of liquidity that they so strongly advocate.

Fortunately, sooner or later the market develops six microeconomic processes that tend to reverse and highlight the mistakes made during the bubble:

The first effect, as I mentioned earlier, is a rise in the price of the original factors of production because the monetary impact causes entrepreneurs to demand them to a greater extent.

Secondly, there is an effect of rising consumer goods prices; this rise is due to the fact that when money reaches entrepreneurs, they pay their suppliers, and so on until it reaches consumers’ pockets. Under these conditions, if the rate of time preference has not changed, the price of consumer goods rises. In addition, the euphoria generates a monetary illusion, a false sense of wealth that pushes society to consume excessively.

A third effect emerges from the above, which is that the profits of companies closest to consumption gradually grow faster than those of investments made with credit expansion, which is in itself a sign that makes entrepreneurs hesitate.

A fourth microeconomic consequence would be the Ricardo Effect, this time in reverse. The increase in consumer goods prices leads to a relative decline in real wages, and therefore entrepreneurs are no longer interested in investing in capital goods to the same extent as before. They begin

to hire relatively more labor, and this has a lethal effect on the demand for capital goods (which are ultimately produced by the stages financed by credit expansion).

A fifth important effect is the rise in interest rates, which occurs after credit expansion has become widespread. The increase in interest rates causes the present value of capital goods to fall significantly in relative terms, and with it the value of the securities that represent them in the various markets.

Finally, all of this means that companies further removed from consumption begin to suffer accounting losses.

There may be many triggers, but what is really important is that, in the end, it becomes clear that, because the market is dynamically efficient, a large part of the investments financed during the bubble period are not sustainable, that is, they are an eco-

nomical mistake: they are an economic mistake because they do not respond to consumers’ true desires regarding how much they want to consume and how much they want to save. In short, it could be said that there has been a general lack of coordination between those who invest, whose investment grew at an average rate of 10% per year during the bubble, and those who save, whose rate grew at zero percent (or even decreased). How is it possible to invest at 10% and save at zero? Simply by making entries in the banks’ liabilities, virtual money. In modern economies, only about one-tenth of the money supply is in the form of cash: banknotes and coins. The other nine-tenths are just entries in the liabilities of banks.

In short, credit expansion leads to a massive miscalculation in the economic system. Entrepreneurs rush to invest as if society’s savings had grown, when in reality they have not grown



When mistakes are discovered, we all get down to work to salvage what we can. A problem begins to be solved when it is detected. That is why Mises said that “recession is undoubtedly the beginning of recovery.”

enough to sustain their investments. In major recessions, there is always some kind of icon that manifests the investment error. In the Great Depression of 1929, it was the Empire State Building; in the bubble of 1991, it was the KIO Towers; and now we have four half-empty towers where Real Madrid plays. What has been done is to produce a structure of capital goods that is erroneous from the point of view of its style, its geographical distribution, and its temporal distribution. Now let's look at the different phases of the crisis.

First, when the market discovers, regardless of the trigger, the mistakes made during the boom, a financial crisis always ensues, followed by an economic recession and finally a budget crisis.

The financial crisis is obvious. What are the banks' assets? The loans they have granted using deposits they have created out of thin air. The two balance each other out. When the market discovers that massive investments have been made in error, the market value of the banks' assets is reduced to a fraction of what was thought, while the liabilities remain the same. In short: overnight, the entire banking system becomes insolvent. If it weren't for the bailouts by central banks, the entire system would have collapsed. Here, central banks act according to the arsonist firefighter syndrome: they are responsible for the expansion, they are the ones who have led us into this situation, but then they present themselves to us as saviors of the homeland.

Secondly, there is an economic recession. At this point, I would like to offer a few words of optimism: when mistakes are discovered, entrepreneurs, families, everyone, we all get down to work to try to save as much as we can from the fire. A problem begins to be solved once it is detected. That is why Mises said that “recession is undoubtedly the beginning of recovery.” In this sense, we have to be optimistic. Just as Keynesians and monetarists are delighted in times of bubble and now appear very concerned, we Austrians are countercyclical and go the other way: we were very concerned during the bubble and now we are relatively optimistic.

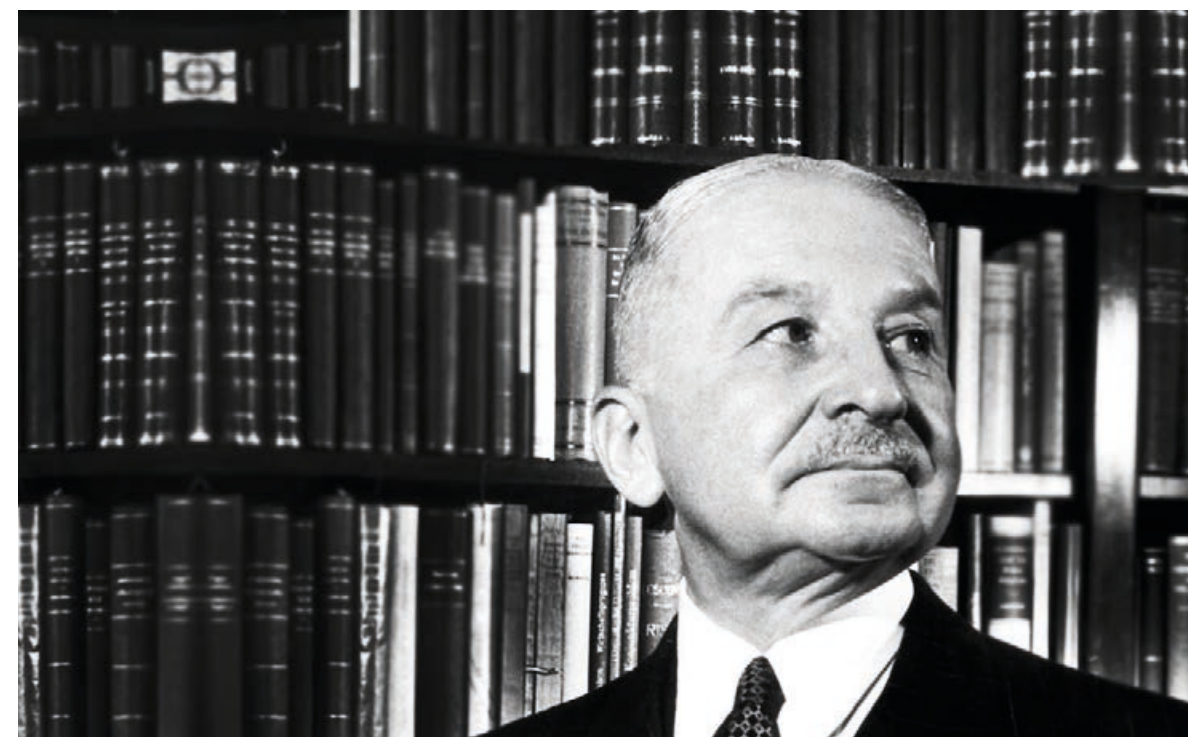
It is true that factors of production and labor must be moved en masse from where they were mistakenly directed to where they should be. In Spain, the adjustment has been very rapid because the market is very fast and efficient. In one year, 200,000 companies have disappeared and unemployment has exceeded five million, with two and a half million directly related to the construction sector: they have been laid off—correctly, because they should not have been working there—as their jobs were not sustainable. Now the task at hand is to redirect these workers to sustainable lines of production. This situation requires a very flexible economy, a market for factors of production, and above all, a very free labor market. This can be a relatively quick process, and the suffering and pain can be relatively short-lived. A society can absorb a great deal of sacrifice if it is relatively short in

duration and if markets are free and flexible. But this requires that taxes not be raised, because in times of recession, businesses, like families, need as much disposable income as possible precisely to “deleverage,” to pay back loans.

Thirdly, we have the budget crisis. Just as much of the investment financed during the bubble is unsustainable, so too is the distribution and volume of public spending. Politicians think this situation will last forever, and then, when revenues fall, they realize they have no money. They are unable to see this because the public accounting figures prevent them from seeing it. This is the situation we find ourselves in now, but in a very peculiar way, because we are also in the euro. I never thought I would witness what I am seeing in my lifetime. Austrian economists have been calling for decades for what has been done timidly and in the right direction in Spain over the last

year. We owe this to the euro, with Professor Bagus' permission.

How will recovery come about? If we withstand the pressure from Keynesians and monetarists (to give more drugs to the drug addict who is now suffering from withdrawal symptoms), recovery will come when there is a downward adjustment of the entire relative price structure. We are not talking about a devaluation, such as would occur if we left the euro, which would distort the entire productive structure and take years to recover from, but rather a readjustment in prices. This is an adjustment that cannot be decided by the government: the sustainable and viable lines that will provide jobs for those five million unemployed and others must be discovered by an army of entrepreneurs on the ground, trying to avoid losses and reap profits in an environment of economic freedom.



Ludwig von Mises.

British MPs Douglas Carswell and Steve Baker introduced a bill in Parliament whose content consists of completing the Peel Act where it was left incomplete.

Recovery is microeconomic and miracles cannot be expected: it requires effort, patience, and time. The thing is, if economic policy mistakes are made, the time needed is longer and the suffering deeper. What we need are statesmen who are able to explain this in simple terms to the public. Have no doubt that we will eventually recover, hopefully within the discipline of the euro. We could say that the euro is acting as a detox center for drug addicts in which we are forcibly confined and from which we cannot escape, because the key is held by a nurse named Merkel. If we could escape, everyone would jump out the window. This is a simile, but it truly describes a situation very close to the current one.

When the recovery comes, and even if it is forced, the tragedy is knowing how long central banks will be able to remember what has happened and be aware of it: how long will it be before economic agents, together with the banking system, start asking again for a new credit expansion and more drugs? I fear that until the world's monetary and banking system is redesigned and reformed, these cycles will continue to occur, unless the three measures we are about to discuss are taken.

On July 24, 1845, Robert Peel said in the House of Commons, and I quote, "whenever banks expand credit, they only create fictitious value, money with no real basis that generates a bubble which, when it bursts, spreads ruin throughout England and disrupts and derails all commercial

transactions." Today, 168 years later, we are still in exactly the same situation. It is incredible that in the 21st century we have inherited a financial and banking system that is the result of this historical accident.

What measures should be taken? The first is obvious: complete the Peel Act where it was left incomplete, that is, require a 100% cash ratio for demand deposits and their equivalents as well. Hayek says that only with this measure would we eliminate the recurring cycles of boom and bust. Furthermore, it should be added that this measure is perfectly in line with the essential principles of property rights required for a market economy to function in a healthy manner. When a depository appropriates part of what has been deposited with them on demand, they are committing the crime of misappropriation: this is a general principle of law. Only a few economic agents have been granted the privilege of committing this crime without being prosecuted: bankers, protected by Article 180 of the Commercial Code, which establishes the possibility of using a cash ratio of 25%. Today, it was 2% according to the European Central Bank, and in January it was reduced to 1%.

There are encouraging signs in this regard, and one of the greatest sources of satisfaction I have had in my life is the fact that a couple of years ago two Tory MPs, Douglas Carswell (MP for Clacton) and Steve Baker (MP for Wycombe), presented a bill in the British Parliament whose content consists of completing the Peel Act where it was left

incomplete. This event was doubly flattering, because in the British Parliament, the cradle of modern democracy, these MPs cited me as the inspiration for the proposal.

What has happened is that George Osborne, the Chancellor of the Exchequer, has watered down the proposal by appointing a commission that concluded, albeit timidly but in the right direction, that commercial banking should be separated from investment banking. In other words, demand deposits can be lent, but only by lending and discounting short-term bills; and, on the other hand, all other transactions that banks wish to carry out must be done through investment banking: in short, it was proposed to reinstate the *Glass-Steagall Act*, which was repealed in the 1990s in the United States. As I said, this is a timid step in the right direction, as there is greater alignment of maturities, but even so, cycles would not be avoi-

ded. Firstly, because there are communicating vessels between loans, and secondly, because bills are discounted at all stages of production, and if there is a process of credit expansion, all of them are distorted. Furthermore, all the major crises in the 19th century were caused by bill discounting. In any case, I recognize that it is a step in the right direction, and the fact that this is already being debated in the terms we are discussing today seems to me to be a huge advance compared to the situation of economic theory and policy until just over five or ten years ago.

Furthermore, the transition to a banking system with a 100% reserve ratio would allow all sovereign public debt to be repaid at no cost to the public purse or to citizens and without any inflationary effect.

The process is very simple and is explained in chapter 9 of my book *Money, Bank Credit, and Eco-*



Douglas Carswell.

Central banks are the last dinosaurs of socialism, the last bastions or organs of central planning remaining in the financial sphere, the generators of the instability that surrounds us.

conomic Cycles. Explained in illustrative terms, it would consist of creating the necessary cash and giving it to the banks to consolidate, equalize, and offset all the demand deposits and equivalents they currently have on their balance sheets. This measure would not be inflationary in any way, because the newly created money, which would be given to the banks and remain on their balance sheets, would be, so to speak, sterilized by the 100% reserve requirement. When taking this first step, something obvious immediately becomes apparent. What happens to all the bank assets that currently counterbalance demand deposits? Well, they would be freed up. These assets in some way represent the process of expropriation of citizens that banks have carried out for centuries through fractional reserve banking. What I propose is to use these assets to set up securities investment funds, whose shares at market price would be exchanged for outstanding public debt securities. According to calculations made by the Cobden Center in England, all English public debt can be repaid as long as the banks commit to operating with a 100% cash ratio from then on.

My plan for transitioning to a 100% reserve ratio is different from the one proposed by Irving Fisher in 1931. Fisher's proposal is extremely dangerous. As an advocate of the 100% reserve ratio, he proposed creating a public agency to purchase bank assets, forcing the income obtained by the agency to be frozen as assets that offset demand deposits. Fisher's proposal is very dangerous

because it would be equivalent to nationalizing the entire economy. From my point of view, I believe that my proposal is easier to implement and would not only solve the problem of cycles but also allow us to make a clean break with public debt.

From that point on, banks would only be able to lend what had previously been lent to them: they would begin to act as financial intermediaries, which is what they should do, and not as money creators that distort the economy, all orchestrated by the central bank.

There is a second principle of reform that we should carry out: abolishing central banks. Central banks are the last dinosaurs of socialism, the last bastions or organs of central planning remaining in the financial sphere, the generators of the instability that surrounds us. With my reform, they would no longer be necessary as lenders of last resort, as banks would maintain a 100% cash ratio. There would no longer be any problems of insolvency in banking with regard to demand deposits. In fact, the theorem of the impossibility of socialism discovered by Mises and Hayek is perfectly applicable to central banking. I have personally written a book entitled *Socialism, Economic Calculation, and Entrepreneurship*, translated into many languages, explaining the debate on the impossibility of socialism.

It is a fact that the entire Austrian theory of the economic cycle is nothing more than a particular case of the theory of the impossibility of

socialism applied to the field of banking, money, and the financial world. It is impossible for central banks or any other planning body to organize society in a coordinated manner, as it is impossible for them to obtain the information they need to coordinate their mandates (this information is not available, as it is constantly being created by entrepreneurs in a free environment). For this reason, socialism is doomed to failure in any field, especially in finance and banking.

The third question we could ask ourselves about reform is the following: who would create the monetary base? Maurice Allais, the French Nobel Prize winner in economics who died just over a year ago, maintained the theory of establishing a public agency that would create public fiat money as the monetary base at an annual growth rate of 2%. With all due respect, although this would be a big step in the right direction, I disa-

gree with Maurice Allais. Money is too important to be left in the hands of politicians and public agencies. Money should not be manipulated by any human being. For this reason, I believe that the monetary system can be nothing other than the classic pure gold standard. The great advantage of the classic pure gold standard is that it cannot be manipulated because to extract a nugget you have to dig two kilometers underground. That is the great advantage of gold.

The classic pure gold standard, by the way, did not fail, as we are led to believe in textbooks: it was deliberately eliminated by politicians because it restricted their policies of vote buying, political patronage, demagoguery, subsidies, etc. If we review the arguments of all those who criticize the euro today, we will see that they are exactly the same as those used to justify abandoning the classic pure gold standard, in the 1930s.



Eccles Building, headquarters of the U.S. Federal Reserve in Washington.

In Europe, we are moving in the right direction thanks to the euro, which acts as a proxy for the classic pure gold standard, disciplining politicians. Any mistake immediately translates into a loss of competitiveness and becomes apparent.

Here in Europe, we are moving in the right direction thanks to the presence of the euro, which acts as a proxy for the classic pure gold standard, disciplining politicians. Any mistake immediately translates into a loss of competitiveness and becomes apparent. We have a European Central Bank that undoubtedly supports banks so that they do not go bankrupt and, in addition, sporadically fails to fulfill its mandate and monetizes debt. This is child's play compared to what its Anglo-Saxon colleagues do, who lost monetary discipline generations ago. Not for nothing is England the birthplace of Keynes. Currently, for example, the US Federal Reserve is directly and unabashedly acquiring 77% of all new Treasury Bill issues; the Bank of England is not far behind, purchasing 25%. With these figures, what the European Central Bank is doing is child's play.

Thank God and the euro, we have no choice but to change our economic model. From a manic-depressive, unsustainable economy based on credit expansion, we must move to a cool, flexible, and sustainable economy based on competitiveness. The secret to success and overcoming the crisis is free markets and obsessing over the future, going to work and being the best. All this, in a single currency environment and as soon as prices readjust, causes investments to pour in like a siphon and unemployment to be reabsorbed. It is the only way out. We are undoubtedly facing a second Stabilization Plan. The first was in 1959, the second in 2012. There is one difference, and

that is that this second stabilization plan does not only affect Spain, but is affecting hundreds of millions of Europeans and many countries under the umbrella of the euro. Not only our future but also that of our children depends on this plan coming to fruition.

Thank you very much.

Amadeo Petitbò:

Professor Huerta de Soto, thank you very much for this lively, brilliant, and enlightening lecture. The first thing I would say is that the pace is unusual. I don't know how many of those present here are Keynesians, pre-Adamites, neoclassicals, Austrians, microeconomists, macroeconomists, supporters of Cambridge UK, Cambridge US... I don't know, but what I am convinced of is that the lecture has not left you indifferent. For some, because it will have challenged their principles; for others, because it will have reinforced theirs. But in any case, Professor Huerta de Soto opens the door to what could be a magnificent debate. I ask all those who wish to speak to refrain from making reflections and to be brief and concise.

Assistant 1:

Professor Huerta de Soto, could you give us some historical examples of contractionary mone-

tary and fiscal policies, such as tax cuts, that have accelerated recovery?

Jesús Huerta de Soto:

Be careful with the idea of accelerating recovery, because this question is already biased with Keynesian linguistic traps.

No one denies that unemployment can be absorbed immediately tomorrow. The problem is that this absorption of unemployment is not sustainable. You can place all the unemployed in public spending, but then when they spend the money—and in general all economic agents—they do not sustain that artificial productive structure. All you have done is postpone the problem at the cost of making it more serious. Milton Friedman and Anna Schwartz have a disastrous book called *A Monetary History of the United States*, and one of

the things they say in it is that they are very surprised because there is a period in history, which is what you asked me about, from the end of the American Civil War in 1865 to 30 years later, during which, with contractionary policy and continuous deflation every year, the greatest growth, in percentage terms, in the history of the United States occurred. They add that “no economic model we know of can explain this paradox.” They didn't know the theory of capital... you can't ask for the impossible.

Assistant 2:

Hello, I am José Villacís, the last living disciple of German Bernácer, creator of macroeconomics in 1916. I agree with most of what you say, especially because you make a very important point about something that is often forgotten by eco-



Gold is an institution just like family, property rights, and the market, which cannot be dismantled without lethal consequences for society.

nomists, namely capital theory. But there is another very important point: money is not created by the central bank or private banks. Money is created by society as soon as it accepts it as a means of payment. On the other hand, the growth of the Gross Domestic Product cannot depend on something as capricious and random as gold; it cannot be. The second part would be that national income springs from production and is therefore equivalent to it. Savings will finance investment, but if real growth is desired, there must be a provision of means of payment, always very, very prudent. Thank you.

Jesús Huerta de Soto:

Professor Villacís, what can I say? I expected nothing else from you. I cordially disagree, but for the reasons I have already indicated. Of course, money is created by society, but it depends on the amount of drugs they give it. As for gold, it provides society with the disciplinary framework it needs to function. Its great advantage is that it has been selected as money in a secular way and through a very long evolutionary process, generation after generation. I don't know if, in the event that civil society were to have its currency returned to it, in a century, two or five, gold would continue to be money. I only know that the history of humanity has chosen gold in an evolutionary and spontaneous way. Gold is an institution just like the family, property rights, and the market,

which cannot be dismantled without lethal consequences for society. Among those consequences, I interpret that which is happening now. In any case, the greatest expert on Bernácer in Spain has my utmost respect and sympathy.

Assistant 3:

Good afternoon, Mr. Jesús. I have a question that has come to mind, and I would like to hear your answer. You are an actuary for an insurance company, and you have just denied the possibility of risk management. I find this strange, since an actuary is, by definition, a risk manager. I would appreciate your clarification.

Jesús Huerta de Soto:

Well, if anyone should understand the distinction between risk and uncertainty perfectly, it is us actuaries. We must separate the world of natural science from the world of human action. We can develop a mortality table that very accurately tells us the number of deaths per thousand people for each age group and, in addition, very approximately the number of traffic accidents or houses that will burn down. But the world of investment, the world of business, of the management of any company, including an insurance company, is beyond what can be modeled mathematically using the risk paradigm. And that is where we fully enter into the concept of uncertainty, in which

each result will depend on the business action taken. Human beings have found a way to deal with uncertainty, but it is not through mathematical models. We can only deal with uncertainty in two ways. The first is through institutions: the framework that disciplines us, including law, morality, etc. If institutions become corrupt, uncertainty multiplies and we cannot act. The second is entrepreneurial alertness, because we tend to achieve what we set out to do in business. There is no guarantee, but if we devote ourselves entirely to moving a business forward, it is likely that the business will succeed.

Entrepreneurship and institutions are the only things that allow us to cope with uncertainty. The great tragedy of Basel III and Solvency II is that all the institutions that have traditionally been tried and tested and have ensured the solvency of the insurance sector have been eliminated one after

another and are to be replaced by “scientific” risk management, which will only serve to reduce solvency, cause confusion in the market, and put the insurance market at risk. I think this is a lethal and key issue, but the problem is that it is perhaps too personal an issue.

Incidentally, there are distinguished economists who have had connections with life insurance companies. One of the things I agree with Keynes on, much to my regret, is that he was also president of a life insurance company. He violated every institution imaginable, introduced the fair market value accounting system (a lethal thing that I haven't had time to talk about, but which has been most damaging in this cycle), distributed unrealized profits, and when the Great Depression hit, his company went bankrupt and he was fired as president. I hope that the fate of my insurance company will be very different.



I am most proud of having established a school in Spain, which is very difficult, and I have five professors who are gems. Two of them are foreigners: Philipp Bagus, from Germany, and Dave Howden, from Canada.

Assistant 4:

Good afternoon, Professor Huerta. I am María Blanco, a professor in the master's program you direct and also a professor at the San Pablo CEU University. I may stray a little from the topic of today's lecture, which did not surprise me. What did surprise me was the number of people I saw in the Rafael del Pino Foundation Auditorium. Following the award given to Juan Ramón Rallo, whom you know so well, the award given to the best researcher under 40 by the Community of Madrid, a series of systematic attacks on the Austrian School have been launched by certain economists from FEDEA and other analysts who brand the Austrian School, which you represent, as unsystematic, unscientific, outside the mainstream, and a thing of dinosaurs and minorities, with no scientific basis whatsoever. I would like to know your opinion, although I suspect I already know it.

Jesús Huerta de Soto:

Things have changed a lot, because when I decided to start my academic career, I had two options: lie, not say what I believed, what I had studied, and what I thought in order to pass the competitive exams, or go against the five professors who were judging me. I finally opted for the second option, and in the end, they gave me the professorship... so things are changing little by

little. This reaction was to be expected because they see the human capital they have invested as being threatened. We professors teach what we know, and if a person has dedicated their entire life to learning general equilibrium, mathematics, Keynes, or monetarist economics, then what we are telling them is that it is a bad investment, that it has ruined their life. They have no choice but to defend themselves, but these are anecdotal and personal issues.

With regard to Juan Ramón Rallo, one of the things I am most proud of is having created a school in Spain, which is very difficult, and I have five professors who are gems. Two of them are foreigners: Philipp Bagus, who is here today, who came one day and said, "Professor, I want to be a professor of economics in Germany and do my doctorate with you," and now he is a professor at Rey Juan Carlos University. Then I have a Canadian, Dave Howden, a genius who is also teaching in Spain. And three Spanish professors, the most brilliant of whom, along with Professor Miguel Ángel Alonso Neira and Professor Gabriel Calzada, who is president of the Juan de Mariana Institute and has just been appointed rector of Francisco Marroquín University, is the aforementioned Juan Ramón Rallo, who has just published a gem of a book entitled *Los errores de la vieja Economía*—paralleling Hazlitt's book on the new economic science—in which he criticizes Keynes' *General Theory* page by page, and for which he has just been awarded the prize by the Community of Madrid. That is "corrupt"

money, so to speak, because it comes from taxes, but at the end of the day, we have to accept it. I am also a civil servant: I can be considered a virus introduced into the system to destroy it, so it is not surprising that those who come from the system want to attack us. Despite everything, they have my full sympathy, and this is everyday life in the theoretical sphere.

The important thing is that, for an academic, the search for scientific truth must be the priority objective in all areas. I don't mind being criticized, being attacked, being told that we are not in the scientific circuits or publications (which is not surprising because they control them). The only thing any researcher should focus on is the search for scientific truth, and here the evolution of events is in our favor, because young scientists who arrive at university are not yet corrupted, they do not yet have misinvested capital: they are only seeking

scientific truth. That is why the future undoubtedly belongs to the Austrian School, which, incidentally, we should rename the Spanish School, because it emerged in Spain during the Golden Age.

Assistant 5:

Professor, I would like to ask you: in an environment of universal manipulation of interest rates, how can we citizens protect the real value of our savings?

Jesús Huerta de Soto:

As someone who sits on many boards, businesspeople always ask me: what should I do to avoid losing money or to make a fortune? And I answer that I don't know, and even if I did, I wouldn't tell them. Why? Because I would take



Philipp Bagus, university professor and disciple of the author.

It is an illusion to think that everything is free.

The link between benefits and their cost has been severed.

Precisely because we have to help those most in need, we must return responsibility for welfare to civil society.

advantage of that business knowledge. The economic theorist does nothing but study economic theory. There is nothing more practical than a good economic theory, that's true. I would recommend that businesspeople incorporate the knowledge of the Austrian School into their conceptual toolbox. There are several investment funds, especially Bestinver, that manage their portfolios according to the teachings of the Austrian School and Professor Huerta de Soto. I don't know how they do it (or rather, I do know), but it's best if you talk to them.

Assistant 6:

I am a student at Rey Juan Carlos University, a student of Juan Ramón Rallo, and I am more or less familiar with his ideology of privatizing everything. As you just said that it is a virus within the system, basically a termite within public education, I would like you to answer me whether it is fair to have public education, public healthcare, a dependency law for the most needy, paid for by everyone's taxes, and a system that is the welfare state, which is not socialism. I want to know if you defend that welfare state, that minimum wage, that kind of thing.

Jesús Huerta de Soto:

First of all, I would like to congratulate you on your courage: first, for being a university student

and second, for asking a very pertinent question. The answer is very simple. Jesús González wrote a book called *From the Welfare State to Welfare with Less State*. The issue is not that we disagree that there should be healthcare, that there should be roads, that there should be pensions, etc. The issue is completely different: by returning responsibility to civil society, can we, for example, have better pensions at the same cost we have now? This is strictly a study of economic theory. We spent two weeks on the program studying how, through *contracting out* or disengagement, gradually moving over a generation to a capitalization system, with the cost currently paid by workers, they can be guaranteed much higher pensions and also have money left over to improve their standard of living. It is a question of means and not ends.

With regard to healthcare, look, civil servants have a privilege that others do not have: we can choose between public and private healthcare. Do you know how many of the two and a half million civil servants in Spain choose private healthcare? Ninety percent. Why don't we give that option to the rest of Spanish citizens? Let those who want to opt out and go to private healthcare pay the cost and have it immediately deducted from their income tax. We would have much greater well-being because what we have now is chaos. It is an illusion to think that everything is free: politicians have infantilized us, and then they have also severed the link between benefits and costs. In terms of efficiency, the cost is immense, and those who

lose out are the most needy. It is precisely because we have to help the most needy that we have to return the responsibility for welfare to civil society.

Attendee 7:

Hello, good afternoon. My name is Fernando Herrera and I wanted to congratulate you on your excellent lecture, Mr. Jesús. My question is one that I have been wanting to ask you for quite some time: the classic pure gold standard is always proposed, but I have the feeling that this is a central planning point in the professor's teachings. It strikes me that, while advocating freedom and lack of regulation for most commercial activities, in the most important one he does not give the option of freedom and decides that money must be gold. Wouldn't a system of monetary freedom be preferable to the classic pure gold standard?

Jesús Huerta de Soto:

If you read my book, you will see that what I advocate is freedom of choice of currency. The only thing is that, since we have to take a leap, make a switch from the current system to the new one once it is 100% consolidated, we have to choose a standard. Once the classic pure gold standard, which has evolved and has been voluntarily chosen by humanity, has been reintroduced, it is of course up to the people to choose. I have never advocated compulsory laws that force people to accept gold as a means of payment, but rather that the exchange be made and then people decide. Any private currency can be proposed. The only thing is that Mises, in his book *The Theory of Money and Credit*, develops what is known as the regressive theorem of money and explains that it is theoretically impossible to create a new standard *from scratch* if there is no anchor to the old one, because economic agents would not be able to calculate the purchasing power it will have

tomorrow. What I intend to do is save that anchor, but from there on, as is logical, there would be total freedom in terms of choosing the currency one wants.

Assistant 8:

Good afternoon, my name is Manuela Mateu, and I would like to say that every day there is talk of the economic crisis in Spain, and you, like many other economists, talk about ways to get out of the crisis. You have spoken, for example, about the free market, and my question is: what are you and your fellow economists waiting for to apply these measures and help Spain get out of the crisis?

Jesús Huerta de Soto:

The mission of an economics professor is the search for scientific truth. Then we give lectures, there are institutions like this one that bring us all together, there is the university, we write articles, and eventually that knowledge filters through, as it did in Sir Robert Peel's England.

Haste is not possible in the social sphere. In England, when I gave this lecture at the London School of Economics, I had the *Tory* MPs in front of me. I told them that if they persevered in their attempt to carry out this reform, they would go down in history as William Wilberforce did, who, thanks to his perseverance, fought for 25 years to abolish the slave trade. In this case, it is a question of abolishing the financial slavery to which the world is subjected. That is not my mission, it is your mission.

Assistant 9:

Good afternoon, everyone. I would like to say that I am a student of Philipp Bagus, and being aware of the situation of the euro, considering the hypothetical exit that he advocates for Germany,

at what exact point do you disagree with Philipp Bagus on the exit from the euro?

Jesús Huerta de Soto:

Philipp Bagus has written a book called *The Tragedy of the Euro*, which is a bestseller that has been translated into every language and in which his analysis is impeccable. He maintains the theory that the “tragedy of the commons” effect occurs, which encourages the least solvent and most prone to public spending to join the euro, and the damage they cause, diluted, is distributed among the rest of the members of the monetary union, and that this will ultimately destroy the system. I would argue that, analyzing the previous cycle, I can only see that the Greek state has been able to act on the basis of this tragedy of the commons effect, because Portugal, Ireland, and Spain were in surplus at the time of the bubble. They were not aware that they were burdening the other members. In any case, the underlying problem is fractional reserve banking and credit expansion, which encourages economic agents to act irresponsibly. Although it may seem paradoxical, from the perspective of all the peripheral countries, the euro is acting like the old classic pure gold standard. It was very easy to leave the old classic pure gold standard. because the old currencies were denominated in francs, marks, etc., and all they did was cut the link to gold. But it is much more difficult to leave the euro; in this respect, the euro does surpass the classic pure gold standard. Imagine how good it would have

been if, in the 1930s, it had been as difficult to leave the classic pure gold standard as it is today to leave the euro. I believe that the euro is a step in the right direction, albeit a very timid one, but it carries all the risks that Professor Bagus points out. I trust that it will hold up. Those who are most opposed to the euro are the Anglo-Saxons, who are at the forefront of the *rating* agencies. In reality, they are terrified because if the euro survives, the dollar’s days as an international reserve currency are numbered, and they know it. All this must be taken into account when we enter the realm of politics and day-to-day practice, when we have to choose between a very great evil and a slightly lesser evil. I consider the euro to be a slightly lesser evil. Europe already owes a lot to Germany. Germany has already more than atoned for its “original sin,” if it ever had one, with World War II and Nazism. Germans are aware that Nazism came about precisely because of what I have explained today, because the entire framework of monetary discipline was abolished with credit expansion and German hyperinflation. We are becoming more like Germany, and I believe that, in this case, Germany deserves to win the war... against inflation.

Amadeo Petibò:

Professor Huerta de Soto, time passes, for better or for worse, as it is today. Thank you for your contribution, thank you all for joining us, thank you to those who asked questions, and see you next time.

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The publisher of *AVANCE de la Libertad* magazine and the supplement you are holding is the Foundation for the Advancement of Liberty (Fundalib), based in Madrid. Since 2015, the Foundation has been working in Spain and internationally for the cause of economic and personal freedom for all human beings. Fundalib is an entity associated with the prestigious Atlas Network, based in Washington, which brings together some 500 pro-freedom think tanks in a hundred countries. It is also a member of European networks such as Epicenter and ELF. The Foundation researches different aspects of freedom in various areas. In particular, it periodically compiles several national and international indices on the state of freedom, including the Regional Tax Competitiveness Index (IACF) and the Economic Freedom Index for Spain’s Cities (ILECE). The IACF was one of the six finalists for the presti-



Fundación para el Avance de la Libertad

gious Templeton Prize in 2024, and the ILECE was awarded the Europe Liberty Award in 2020. Fundalib has won several other awards and distinctions, notably first place in the international think tank competition organized by the European Resource Bank in Chişinău (Moldova) in 2019. The two documentaries produced by the Foundation have been included in the official selection of festivals in the United States and South Korea,

and one of them won an international specialized festival (New York, 2023). The Foundation supports various civil society activist organizations and is a top publisher of books on the ideas of freedom. The Foundation’s publications are available on the fundalib.org website, including the series of Brief Reports on Current Issues. Since June 2020, the Foundation has been publishing the aforementioned monthly magazine, which provides readers with brief opinion pieces aimed at spreading ideas throughout society. With a classical liberal and libertarian orientation, the magazine covers the entire ideological spectrum from classical liberalism to agorist and ancap positions, as well as objec-

tivist philosophy. Fundalib thus seeks to promote the various families of individualism, aware of the fearsome resurgence of various forms of collectivism in our time, generally through the various populisms

that are regaining political ground.

Since 2021, this magazine of short articles has been complemented by the supplement *Cuadernos para el Avance de la Libertad*. What you are looking at is an English edition of one of those *Cuadernos (Papers)*. On page 2 of this Paper, readers will find the code and web address to subscribe to the magazine, and on the website there are several other options for joining and supporting Fundalib.

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