

## FRÉDÉRIC BASTIAT'S VIEWS ON THE NATURE OF MONEY

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**W**hat is money? This is a question for the ages. Humanity has risen into complex society and experienced tremendous economic development and high cultural achievement through the use of money. It has foundered or even been destroyed when money has been undermined. Ignorance of the nature of money should therefore be the central economic issue for society.

Frédéric Bastiat was a French businessman who lived during the first half of the nineteenth century (1801-1850). In the last few years of his life he was elected to the national assembly and began a prolific career as a writer on topics of economics, public policy, and political issues of the day.

His highly effective writing style includes the use of humor, ridicule, dialogue, irony, exaggeration and, most important, logical deduction and the process of elimination. He is like a mystery sleuth in search of economic truth and this style has made him the undisputed champion in economic polemics. He continues to earn high praise from journalists, economists, and most important, from educated readers more than 150 years after his death.<sup>1</sup>

In contrast to the universal respect and admiration for his literary skills, Bastiat has not been admired as an economic theorist. His efforts at economic theory have been roundly criticized and characterized as the efforts of an amateur or even a crank. We can list the eminent economist Joseph Schumpeter and Nobel Laureate F.A. Hayek, two outstanding economists, among the critics of Bastiat as an economic theorist.

I have re-examined Bastiat's contributions to economic theory and have found the charges against him to be unsubstantiated. In terms of economic theory, Bastiat is widely knowledgeable, keenly discerning, highly competent, and very creative. Furthermore, I have concluded that the central criticisms of

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<sup>1</sup>Even the president of the Federal Reserve Bank of Dallas, Dr. Robert McTeer, has heaped high praise on Bastiat's writings.

his detractors are unjustified, because they are based on an interpretation of Bastiat's theories that is at odds with the large body of Bastiat's views on economics. These critics place Bastiat in a camp that believes that people do not benefit from trade (zero sum theory of exchange) and that the value of a good actually resides within the good itself (intrinsic value). It is simply preposterous to believe that Bastiat held such beliefs and to interpret his theory in this manner. Bastiat was arguably the most consistent economist of all time, an achievement that was nurtured by many years of serious study before embarking on his political and publishing career a few years before his death. There may be something wrong in Bastiat's theoretical framework, but these critics have not identified it (Thornton 2001, pp. 387-98).

Had Bastiat lived to see the publication of his theoretical treatise, he would no doubt have defended and clarified his views, possibly modifying those views or their presentation. Bastiat certainly loved intellectual debate, and few people of his day or ours would relish going to battle with him.

Bastiat has received criticism in the area of monetary theory. Hayek wrote in the introduction to an edition of Bastiat's *Selected Essays on Political Economy* that Bastiat should not be blamed for his failure to address the important problems of monetary economics because Bastiat lived during the heyday of the international gold standard. With so many other problems in his day, why should Bastiat search for a solution where no problem existed?

The attentive reader will notice that, while Bastiat grapples with so many economic panaceas which are familiar to us, one of the main dangers of our time does not appear in his pages. Though he has to deal with various queer proposals for using credit which were current in his time, straight inflation through a government deficit seemed in his age not a major danger. An increase of expenditure means for him necessarily and immediately an increase in taxation. The reason is that, as among all people who have gone through a major inflation within living memory, a continuous depreciation of money was not a thing with which people would have put up with in his day. So if the reader should be inclined to feel superior to the rather simple fallacies that Bastiat often finds it necessary to refute, he should remember that in some other respects his compatriots of more than a hundred years ago were considerably wiser than our generation. (Hayek 1964, pp. xi-xii)

Many writers have appealed to Bastiat's writings on other subjects to analyze monetary problems and to offer monetary solutions. For example, appeal has been made to his views of the nature of government or trade to illuminate monetary issues. Others have tried to reconstruct what Bastiat would believe about money and some of these attempts can be judged quite successful.

I have searched through Bastiat's writings for something—anything—on monetary economics and have finally found an essay, "Maudit Argent" (1849)<sup>2</sup>. A translation of the essay appeared in English, in a long lost volume

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<sup>2</sup>Translation is "What is Money?" It was translated and published into English by David Wells in 1877. All page references here are to this translation unless otherwise noted.

of Bastiat's essays, by the great American economist David Wells in 1877. We are now able to clearly see if Bastiat has any economic lessons for us in the area of monetary economics.

Modern economists would probably scoff at the notion of using the dialogue method to present economic theory, but Galileo used it to describe the nature of the universe, and Plato certainly used it to good effect. Bastiat used dialogue to address the question, "What is money?" It is a dialogue between an economist who represents Bastiat's views and who begins the dialogue by shouting "Hateful money! hateful money!" (p. 174) after leaving a Committee of Finance meeting where a project of paper money has been discussed. His discussant is an acquaintance and an educated layman willing to learn how a failure to understand monetary theory "is to be found at the root of all economical errors" (p. 177).

Bastiat begins his detailed analysis of the nature of money with a stunning statement when he calls "drafts on the Bank of Exchange" a "deceitful substitute" for money. This clearly implies that banknotes and deposit accounts are fraudulent when they do not represent commodity money in the same way warehouse receipts represent the titles to nonmonetary commodities. Bastiat therefore begins his dialogue by labeling fractional reserve banking practices as a fraud on the general public.

Bastiat goes on to explain that the confusion of money and riches or wealth is the "cause of errors and calamities without number" (p. 176). Money is genuinely beneficial—indeed, it plays a critical role as the medium of exchange—but people confuse money with wealth. This is not a problem for the deluded individual who readily ignores this mistaken belief every time he gets hungry or thirsty and converts money into goods. However, when this mistaken belief becomes acceptable public policy all manner of destruction can be unleashed:

Because, when a man, instead of acting for himself, decides for others, personal interest, that ever watchful and sensible sentinel, is no longer present to cry out, "Stop! the responsibility is misplaced." It is Peter who is deceived, and John suffers; the false system of the legislator necessarily becomes the rule of action of whole populations. (p. 179)

When government concludes that money is wealth and enacts policies to draw money away from other nations, it accepts the doctrine that an individual and a nation can only prosper at the expense of others. In order to increase wealth, people must be prevented from spending their money on imports even if they are hungry, and must also be compelled to export their goods in order to increase the amount of money in society. An expensive system of custom-houses will be necessary to prohibit imports and an expensive system of export subsidies will be necessary to encourage exports and all of this will require a large tax to be laid on the people. If other governments adopt the same view, then you must raise armies and navies to establish colonies and conquests that will then serve as customers for your goods and sources of

money. If they in turn raise armies to contest your colonies and conquests, the process—"universal war" (p. 187)—becomes self-defeating and very expensive.

And, tell me, are not these custom-house officers, soldiers, and vessels, these oppressive taxes, this perpetual struggle towards an impossible result, this permanent state of open or secret war with the whole world, are they not the logical and inevitable consequence of the legislators having adopted an idea, which you admit is acted upon by no man who is his own master, that "wealth is money; and to increase the amount of money is to increase wealth?" (p. 186)

Of course, universal war is not the only result of the idea that increasing the supply of money can make us richer. Along with protectionism, colonialism (imperialism), heavy taxes, and the hatred of capital comes "the last and worst, paper money" (p. 188).

When legislators, after having ruined men by war and taxes, persevere in their idea, they say to themselves, "If the people suffer, it is because there is not money enough. We must make some." And as it is not easy to multiply the precious metals, especially when the pretended resources of prohibition have been exhausted, they add, "We will make fictitious money, nothing is more easy, and then every citizen will have his pocket-book full of it, and they will all be rich." (p. 188)

Bastiat then goes on to show that the notion of money as the source of wealth is incorrect, that trading goods and services is mutually beneficial, and that trade is merely facilitated by the use of commodity money as the medium of exchange. He then reinforces this point by noting that any rare metal can serve as money and that any quantity will be sufficient to serve as money. The policymaker need not increase the money supply at all:

Money serves only to facilitate the transmission of these useful things from one to another, which may be done equally well with an ounce of rare metal like gold, with a pound of more abundant material as silver, or with a hundredweight of still more abundant metal, as copper. According to that, if a country like the United States had at its disposal as much again of all these useful things, its people would be twice as rich, although the quantity of money remained the same; but it would not be the same if there were double the money, for in that case the amount of useful things would not increase. (p. 191)

Bastiat is adamant that any increase in the supply of money does not benefit society and does not increase satisfaction. You simply do not make the citizenry better off by forcing them to give up useful things in return for newly created money. What is good for the individual (more money) is not good for the nation as a whole, and Bastiat invents an ingenious game to explain inflation and debasement. He then explains that money represents value that the holder has provided to someone else in society either by goods or labor, and the holder can take money and exchange it with others for goods or labor of

a similar value. Bastiat laments: "It is impossible for society to render more services than it receives, and yet a belief to the contrary is the chimera which is being pursued by means of the multiplication of coins, of paper money, etc." (pp. 200-01). You cannot solve the problems of society, nor raise the standard of living simply by increasing the supply of money.

Bastiat's companion asks, why not give an increase in the supply of money a try, even if it will not work. At least it will not cause any harm and will give people some hope that social problems can be addressed. Beginning with a fictitious construction similar to what is now referred to as the helicopter model, Bastiat replies "after the issue of paper money and its depreciation, the equilibrium of values should instantly and simultaneously take place in all things and in every part of the country" then "the best thing we could do would be to look at one another and laugh" (p. 205).

But this is not how it works in the real world. When you force people to take false money in return for real goods and services, the alteration of money creates real changes in the world, and, rather than providing a mechanism for solving real-world problems or even of just providing hope to the poor and the downtrodden, inflation actually creates real problems and injustices for the least advantaged members of society.

I must inform you, that this depreciation, which, with paper, might go on till it came to nothing, is effected by continually making dupes; and of these, poor people, simple persons, workmen and countrymen are the chief. (p. 206)

During inflation the ability to calculate is blurred and this is especially so among the average working class people who are unable to identify the reason for their impoverishment. Bastiat notes that a "day's pay of a country laborer will remain for a long time at a dollar while the salable price of all the articles of consumption around him will be rising" (p. 211). He goes on to note that, because the rise in prices cannot be "instantaneous and equal for all things" (p. 212), inflation also contributes to the chief problem of those who wish to use money to solve social problems, the inequality of wealth in society.<sup>3</sup>

Sharp men, brokers, and men of business, will not suffer by it; for it is their trade to watch the fluctuations of prices, to observe the cause, and even to speculate upon it. But little tradesmen, countrymen, and workmen will bear the whole weight of it. (p. 212)<sup>4</sup>

There are many more problems with inflation, but the discussants grow weary. Bastiat tries to summarize his conclusions by noting that "these questions

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<sup>3</sup>Bastiat addresses the problems of credit in other articles and therefore does not consider the problems of inflation induced credit expansion and the business cycle.

<sup>4</sup>Wells then provides an extensive footnote that documents a real-world case in which inflation contributes to the inequality of wealth.

are of the highest importance; for peace or war, order or anarchy, the union or antagonism of citizens, are at the root of the answer to them” (p. 217), and goes on to question, how can all civilized nations avoid the study of such critical information. Bastiat’s companion replies that the state fills men’s minds with prejudices and sentiments “favorable to the spirit of anarchy, war, and hatred” (p. 218), because the state takes us at an early age and:

It puts a bandage over our eyes, takes us gently from the midst of the social circle which surrounds us, to plunge us, with our susceptible faculties, our impressionable hearts, into the midst of Roman society. . . . How can you expect them to take the slightest interest in the mechanism of our social order? (pp. 218-19)

Bastiat ends the dialogue with his recommendation for reform:

The most urgent necessity is, not that the State should teach, but that it should *allow* education. All monopolies are detestable, but the worst of all is the monopoly of education. (p. 220)

Clearly, rumors of Bastiat’s lack of interest in monetary theory have not only been exaggerated, they are patently untrue. Indeed, Bastiat places the role of money at the center of the economy and portrays ignorance of its nature as one of its greatest dangers. Not only does he explain the nature of money, but he also very cogently explains the inevitable results of a failure to understand that nature.

Bastiat’s analysis is so advanced that it is prophetic. Not only does he explain the inevitable consequences of mercantilist monetary policy, but he also goes on to explain the critical weaknesses of modern equilibrium approaches to monetary theory and monetarism. As one views the world and sees global economic chaos, growing class conflict, widely divergent economic opportunity, and perpetual war, Bastiat provides a clear and concise guide to its cause. Bastiat’s solution no doubt rests in the true understanding of the nature of money by the citizens, the abolition of fiat money and central banks, and a return to commodity money such as gold and silver coins.

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