
A New German Post-Historical School Monetary Paradigm:

A Comparative Analysis of Mises' and Knapp's Theories
in Light of the *Methodenstreit* and the State of German Economics in the Early
20th Century

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Word Count: 8240

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Abstract

This paper conducts a comprehensive examination of the monetary theories presented by Ludwig von Mises and Georg Friedrich Knapp, contextualizing them as part of a new post-Historical School paradigm in German-speaking Economics. Knapp's chartalism, which emphasizes the role of the state in determining the value of money, gained widespread acceptance in the early 20th century, particularly in the German-speaking world. Mises, on the other hand, put forth a contrasting theory that stresses media of exchange as a spontaneous emergence, through the application of methodological individualism and subjectivism to money. Mises raises fundamental concerns regarding the adequacy of chartalism in explaining contemporary monetary phenomena. He argues that chartalism lacks a coherent framework for understanding the value of money, which has critical implications for monetary policy. This paper highlights the consequences of this chartalist paradigm, particularly during periods of significant monetary turmoil, such as the inflationary crises in Germany following World War I. Through a critical analysis of Mises' objections and concerns, it highlights the pivotal role of economic theory in shaping academic discourse, economic policies, and real-world economic realities. Ultimately, the paper underscores the importance of sound economic analysis in guiding societies and economies, emphasizing the enduring relevance of these monetary theories and their broader implications for our understanding of money and monetary policy.

In the context of the 19th century German-speaking world, two radically different theories of money emerged, each in stark opposition to the other. Out of the *Methodenstreit* controversy, Georg Friedrich Knapp developed his chartalist¹ theory of money, which emphasizes the role of the state in creating and maintaining the value of money, while Ludwig von Mises developed his catallactic² theory of money, which emphasizes the role of market forces in determining the value of money. Although both theories departed from the German Historical School, they did so in different ways, forming two new paradigms that have had a lasting impact on economic theory. While Knapp's chartalism is not as widely recognized in mainstream economics as Mises' catallactics, it has nonetheless been the subject of academic discussion and analysis. Interest in Knapp's chartalism has experienced a resurgence in interest in recent years, particularly in the context of Modern Monetary Theory (MMT). Despite their differences, both Knapp's and Mises' theories of money remain relevant to contemporary economic discussions and continue to offer insights into debate in economics on the nature and function of money. In developing an understanding through a detailed contrast of these two theories, which emerged from the same socio-historical and academic landscape, a higher comprehension of the scope and significance might be achieved. Moreover, it could also shed light on modern debate in economic theory, informing insightful arguments in regard to MMT and scholarly debate concerning the theory of money and its value.

Knapp and Mises were, broadly speaking, contemporaries and rose to eminence in the chaos and disunity the economics of the German speaking world found itself in following the

¹ Chartalism is a term ascribed to theories of money, especially Knapp's, which emphasize governmental directed economic activity as the cause of the invention of money. It echoes Knapp's quote "Money is a creature of the law" (Knapp 1905, 1). We may understand chartalism as "the doctrine that money is peculiarly a creation of the State" (Keynes [1930] 2013: 4).

² Catallactics as used by Mises is defined as a theory of how exchange ratios and prices are reached in a free-market system/economy. Mises' theory as such is one of how in a world of free and spontaneous exchange money and media of exchange emerge

Methodenstreit controversy. Mises -the academic grandson to the instigator of it all, Menger- was the pupil of Böhm-Bawerk, who himself was the student of Menger and a part of a new “Austrian” school that emerged in Vienna. The new Austrian school saw itself as a clear break from the German Historical school through its unique emphasis on universal theory and deductive reasoning. To understand Mises’ theory of money thoroughly, it is essential to note the influences of Menger and Böhm-Bawerk, as they form the foundation of his approach. Mises builds on their arguments through extending Menger’s notion of market forces understood through methodological individualism, and Böhm-Bawerk’s concept of time preference onto money and value theory. Knapp on the other hand grew up very much in the milieu of traditional German academia through his father’s assumption of professorship in Munich in his early youth.³ Knapp went on to study *nationalökonomie*⁴ and become one of the leading figures in the Young Historical School together with Gustav Schmoller. Unlike Mises, Knapp does never rejected the German historical school explicitly and heavily relied on empiricism and historical evidence to support his theory of money. Yet, his approach in his later work, *Die Staatliche Theorie des Geldes*, is not completely harmonious with the prominent idea within the Young Historical School that universal theories and laws are impossible in economics. It does in some sense go against this notion perpetuated by Schmoller and prominently adopted by German academia at the time as he does aim at developing a universal “chartalist” theory of money, albeit through historical methods. These observations give way to the categorization of Mises’ and Knapp’s theories as part of a new post-German historical school paradigm emerging in the early 20th century.

³ “Knapp, Georg Friedrich,” Deutsche Biographie, September 28, 2023, <https://www.deutsche-biographie.de/gnd118723650.html#ndbcontent>.

⁴ The name given to economics in the German world at the time. It can be translated to political or national economy. It is interesting to note that the study *nationalökonomie* did differ in focus and theory from its English and French counterpoints, and is not fully comparable to what was then called ‘Political Economy.’

Knapp, Mises, and the *Methodenstreit*

What exactly the German Historical School constitutes, let alone whether it is a coherent school of thought, has been the subject of much scholarly scrutiny and debate. To understand Mises and Knapp's position in reference to the German Historical School, it is imperative we first understand what it exactly constitutes (if it does constitute any coherent thing at all). The school can be roughly divided into 3 smaller schools: the old Historical School, the young Historical School, and the youngest Historical School. Though the Historical school begins with the thinkers of the old school- namely Roscher (its "*Führer*"), Knies, and Hildebrand- and many of the foundational ideas originate from them, the two central figures of the Historical "School" are Schmoller and Althoff. For a body of scholarly work over a certain period of time to be characterised as a school of thought it requires a common thread to run through the ideas of its intellectuals. That common thread for the Historical School can be found in the Althoff system which allowed Schmoller to dominate German political economy. Bruce Caldwell characterizes their influence in the following manner:

In 1882 Schmoller was offered a chair in political economy at the University of Berlin, a post he would hold until 1913. In the decade preceding the move he had been a professor in Strasbourg, and one of his friends there was Friedrich Althoff. In the same year that Schmoller went to Berlin, Althoff was invited to serve in the section of the Prussian Ministry of Education responsible for recommending university appointments. Althoff's actual power soon extended far beyond Prussia, such that in time he came to be known as "the secret Minister of Education" or "the Bismarck of German universities." And because Althoff was quite willing to follow his friend Schmoller's advice in making appointments, Schmoller soon had an unofficial title of his own: "the Professor maker" (Balabkins 1988, 48-49; Mises 1969, 26-27; Epstein 1917, 437).⁵

This system caused the professorship of the German Empire to become filled by appointments sympathetic to Schmoller and his intellectual inclinations. The kind of work done by economists under this system shifted heavily into the historical methods of work and

⁵ (Caldwell 2001)

research favoured by Schmoller, and caused a neglect and antipathy towards theoretical work, shaping German economic thinking, especially evident in the emerging anti-theoretic character. It is because of Schmoller's influence in making appointments that his attitudes translated into general characteristics of German economic thought.⁶ The prestige of the German universities and the dominance of these methods in turn caused the other German speaking universities in Austria to adopt a similar "historical" approach to economics in an effort to stay relevant in central European academia. Schumpeter (1954, 808) summarizes the consequent school of thought with the proposition that "the economist, as a research worker, should be primarily an economic historian."

It was in this context of economics in the German speaking world that both Mises and Knapp emerged in the profession. Both, at the beginning of their careers, were economists who worked within the Historicist Paradigm, as exemplified by the titles of their early publications. Mises' first publication in 1902, titled *Die Entwicklung des gutsherrlich-bäuerlichen Verhältnisses in Galizien: 1772-1848* ("The Development of the Relationship between Lords of Manor and Peasants in Galicia: 1772-1848"), reveals that as a student Mises too primarily worked as an economic historian, as there is no theory present in the paper.⁷ von Mises ([1978] 2009, 104) himself writes:

It followed that I saw no possibilities for economic science when I entered the university. I was convinced that economic history must make use of the means and methods of the historical disciplines and could never yield economic laws. I believed that there was nothing in economic life that could be made the object of scientific analysis outside of economic history. There could not have been a more consistent follower of historicism than I.

⁶ "Schmoller rejected the use of abstract concepts as tools of economic analysis, the individualism, the materialism, and the narrow field of the classical economists" (Krasnozhan and Buynk, 2017).

⁷ Mises was a student at the University of Vienna under Carl Grünberg, a Marxist, member of the Younger Historical School, and the future founder of the Frankfurt School (Krasnozhan and Buynk, 2017).

Knapp, being a more integrated part of the historical school published a series of writings on statistical and historical research before his publication of the *Die Staatliche Theorie des Geldes* (State theory of Money) in 1905.⁸ All except one of these deal with statistical work or economic history, with the exception being “The theory of population fluctuations” (Knapp, 1874). Knapp’s other work however is very in line with Schmoller’s Historicism.

Yet Schmoller’s grip on economics in Germany and Austria was under attack when a disagreement, over the possibility of universal economic laws, with the Austrian economist Carl Menger sparked the *Methodenstreit der Nationalökonomie*.⁹ Though Menger published his *Grundsätze der Volkswirtschaftslehre* in 1871, it was only by the late 1890s and early 1900s that Menger and his followers were able to get Schmoller to make a public concession about theory (specifically deductive reasoning) in economics:

By the year of 1900, the battle of the methods led Schmoller to make a compromise that both deductive and inductive methods are as indispensable for economic research as left leg and right leg are for walking (Pribram 1983, 220).¹⁰

It is in the milieu of weakening anti-theoretics in the German speaking world where both Knapp and Mises publish their works on the theory of money. The shifting attitudes regarding deduction and theory allowed for work to be done that involved the finding of economic laws and not be immediately discredited. Their work represents a new approach in a post-German Historical paradigm to money in the economics of the German speaking world. Though Knapp was a part of the Historical school, this work

⁸ The names of Knapp’s publications before the State Theory of Money are as follows: (1868). *Über die Ermittlung der Sterblichkeit* (“On the ascertainment of mortality”); (1869). *Die Sterblichkeit in Sachsen* (“Mortality in Saxony”); (1871). *Die neuern Ansichten über Moralstatistik*; (1874). *Theorie des Bevölkerungs-Wechsels: Abhandlungen zur angewandten Mathematik* (“The theory of population fluctuations”); (1887). *Die Bauern-Befreiung und der Ursprung der Landarbeiter in den älteren Theilen Preußens*. Vol. I. Leipzig: Duncker & Humblot. (“The liberation of peasants and the origins of the agriculturalist in the older parts of Prussia”); (1887); *Die Bauern-Befreiung und der Ursprung der Landarbeiter in den älteren Theilen Preußens* (in German). Vol. II. Leipzig: Duncker & Humblot. (“The liberation of peasants and the origins of the agriculturalist in the older parts of Prussia”); (1891). *Die Landarbeiter in Knechtschaft und Freiheit: vier Vorträge* (“The farmer in serfdom and freedom”).

⁹ It should be noted that when Menger originally published his *Grundsätze*, he dedicated it to the German Historical School and Schmoller. It was however rejected in a very public and dismissive manner, causing Schmoller to state that universal economic laws were impossible and a feud between the Austrian and German schools emerging.

¹⁰ (Krasnozhan and Buynk 2017).

breaks from the epistemological and methodological standards adhered to under the Althoff system. The differences and similarities in approach between Mises and Knapp, and perhaps their broader theories as a whole, can be best understood through an investigation of their respective conceptions of the definition, origin, and value of money.

Mises Catallactic theory of the aetiology of Money

Mises' aetiology of money is heavily inspired by the argument made by Menger in his "*Grundsätze der Volkswirtschaftslehre*" (Principles of Political Economy). Menger argues that money was not, as Knapp argued, created by the administrative power, but instead was a product of spontaneous order in markets. The question of how societies went from barter to money is answered in this Mengerian fashion by Mises. Barter, or as Mises terms it, direct exchange, is exchange where "a medium of exchange is [not] involved" (Mises, 1912, p.42). For exchange to occur, both parties must desire the good the other party possess, meaning their subjective valuations need to be compatible; exchange is unsurprisingly very limited under these conditions.

If a would-be buyer thinks that the price demanded by a would-be seller is too high, because it does not correspond to his subjective valuations of the goods in question, a direct exchange will not be feasible unless the would-be seller reduces his demands. (Mises, 1912, 185)

Indirect exchange, moreover, is made more paramount by the fact that it is a necessary prerequisite for division of labour to occur and develop in a society. A shoemaker, who only produces shoes, can only trade other goods for shoes for as long as the individuals he can trade with still have demand for shoes. However, due to diminishing marginal utility the value of each n^{th} pair of shoes decreases until the other party simply will no longer trade for shoes. In a society where only direct exchange occurs, it is unlikely that he would only concentrate on producing shoes and would instead provide for his own autarky. This would

sacrifice the gains in marginal productivity (the amount of volume for each input) he could make if he were to only concentrate on making shoes. The shoemaker will only make shoes when he is able to exchange them for other goods (either directly or indirectly). Certain goods will have less elastic demand and will be sought after or accepted by most people, either because they intend to use the good themselves, or because they know that others would be willing to accept the good in an exchange. These goods can be used as mediums of exchange (MoEs), allowing for greater division of labour seeing as a greater number of exchanges become feasible. Through this spontaneous process early markets adopted commodities -which possessed certain characteristics- such as salt, tobacco, or cattle, as mediums of exchange and allowed for indirect exchange. Now, if the shoemaker wishes to trade with another individual who has satisfied his demand for shoes, he can instead offer a good that is an accepted MoE- such as salt- in exchange for the other parties good. This according to Menger and Mises, is how indirect exchange comes into being.

The argument then follows that as time progresses commodities that meet certain characteristics, such as marketability, divisibility, durability, homogeneity, transportability, and recognizability will be adopted as “commodity money.”¹¹ The properties of metals such as gold and silver therefore lead them to become widely accepted as money or currency; however, these faced the problem of transportation due to their weight. This in turn was then solved by the use of certificates which could be exchanged for their worth in metals, creating what Mises terms fiduciary media. The development of these money certificates ultimately then resulted in fiat money, due to belief and confidence people developed in the issuing institutions. Mises defines Fiat money as “a money consisting of mere tokens which can neither be employed for any industrial purposes nor convey a claim against anybody (Mises

¹¹ For Mises the term money applies to anything that is accepted as a common medium of exchange. “Money is the thing which serves as the generally accepted and commonly used medium of exchange.” (Mises 1949, 398). As such any commodity or certificate that is used as a common medium of exchange is by definition a form of money.

1949, 426).” The value of this money comes from the expected ability to be able to purchase other goods, its utility is its exchange value, not any intrinsic property or notion. The case of fiat money illustrates the problem of elucidating its value and the need for more nuanced explanations which do not involve “intrinsic values” of commodities or debt.

Mises approaches this problem with his regression theorem. von Mises (1949, 405) states that the “problem is to conceive the determination of the purchasing power of the immediate future, of the impending moment. For the solution of this problem, we refer to the purchasing power of the immediate past, of the moment just passed.” Our expected purchasing power for the immediate future, on the basis of which we engage in purposeful action with media of exchange, is based in our minds on yesterday’s purchasing power (I.E. “the value in exchange of a medium of exchange” as caused by the “cumulative effect of both partial demands”).¹² This regression can be continued, deriving yesterday’s expected purchasing power from the prior days purchasing power and so forth, until one reaches the point where “the service of the good concerned as a medium of exchange begins (Mises 1949, 406).” At this point we would be left with the nonmonetary/industrial value of the good. However, the value of the MoE is not determined by the nonmonetary value of the original good, rather it is the knowledge of the pasts purchasing power that make it valuable, it creates a sentiment of reliability in terms of exchangeability and stability in our minds. Hence if, as Mises proposes in a thought experiment, we were to lose knowledge of the past purchasing power of the money, use of the MoE would be discontinued and we would have to start anew in developing a MoE.¹³ We can consequently understand today’s purchasing power of money in the following way:

The relation between the demand for money and the supply of money, which may be called the money relation, determines the height of purchasing power. Today’s money

¹² The two “partial” demands mentioned here are “[1] the demand displayed by the intention to use it in consumption and production and [2] that displayed by the intention to use it as a medium of exchange.” See L. von Mises, *Human Action*, p. 405

¹³ See L. von Mises, *Human Action*, p. 408

relation, as it is shaped on the ground of yesterday's purchasing power, determines today's purchasing power.¹⁴

The money relation for Mises is the ultimate cause of the value we assign to MoE. But we cannot have a money relation without the knowledge of past purchasing power, which constitutes the information the individual economic agent bases his demand on money with, whilst also determining its supply. Money, and media of exchange in general, are economic goods, and aren't treated as neutral or separate from the economy, they are very much a part of it.¹⁵ However, there are various factors other than past purchasing power that effect demand for money;¹⁶ Mises (1949, 401) lists them as the following:

Such factors are: the population figure; the extent to which the individual households provide for their own needs by autarkic production and the extent to which they produce for other people's needs, selling their products and buying for their own consumption on the market; the distribution of business activity and the settlement of payments over the various seasons of the year; institutions for the settlement of claims and counterclaims by mutual cancellation, such as clearinghouses. All these factors indeed influence the demand for money and the height of the various individuals' and firms' cash holding.

Money just like any other economic good serves to alleviate felt uneasiness, it has a utility to each individual. This means that its valuation is also subjective to each individual and our demand for it is determined by its subjective utility. To say that money has a constant value for Mises ignores the reality that we are constantly weighing goods and their comparative opportunity costs against each other. We value the first \$100,000 dollars we earn more highly than the second, because money -just like every other good- is subject to diminishing marginal utility. Money is not a mere channel of our actions, but as Mises (1949, 416) states:

With the real universe of action and unceasing change, with the economic system which cannot be rigid, neither neutrality of money nor stability of its purchasing power are compatible. A world of the kind which the necessary requirements of neutral and stable money presuppose would be a world without action. It is therefore neither strange nor

¹⁴ *Ibid*, 408

¹⁵ "Media of exchange are economic goods. They are scarce, there is a demand for them (Mises 1949, 398)."

¹⁶ It should be noted that knowledge of a goods past purchasing power is necessary for it to be a MoE. This was illustrated by the example given on how if this knowledge were to disappear, we could no longer use the good as a MoE.

vicious that in the frame of such a changing world money is neither neutral nor stable in purchasing power. Money is an element of action and consequently of change.¹⁷

Knapp's Chartalist theory of the origin of Money

In his state theory of money, Knapp aimed to provide an explanation for the existence of paper money within the context of a German society where the prevailing academic view was rooted in metallism. As Knapp states in his Author's Preface to *The State Theory of Money*: "I gained my earliest impression as to currency questions in 1861 from a summer journey in the Tirol, where there was only paper money in circulation" (Knapp 1905). Knapp's Theory of Money is written largely to address the doctrine of metallism, which asserts that the value of money is tied to its exchangeability for a certain quantity of precious metals (specie). The advent of paper money, and the fact that it is being used and valued by people (as was the case in Tirol in 1861 that Knapp notes) perplexed metallists. Simply put, it presented a phenomenon their theory was not able to explain.¹⁸ Knapp argues we need to investigate paper money for this very reason, as it will reveal significant insight into the nature of money.

"For on close consideration it appears that in this dubious form of "degenerate" money lies the clue to the nature of money, paradoxical as this may at first sound. The soul of currency is not in the material of the pieces, but in the legal ordinances which regulate their use." (Knapp 1905, 2)

Chartalism is Knapp's attempt to explain this phenomenon and build a theory that explains all means of payments. One could mistake Knapp's argument for one trying to replace the metallic standards with a fiat paper money standard. However, Knapp makes it very clear that he is not trying to dismiss metal as a monetary standard, in fact quite far from it: "Nothing is further from our wishes than to seem to recommend paper money pure and simple in a form,

¹⁷ The idea of neutral money is an important point when comparing Mises and Knapp, and is one of the biggest tensions which will be explored in more detail later

¹⁸ "No theory of the metallists deals fairly with nonmaterial money (Knapp 1905, 53.)" "But the metallists fail to explain currency systems that have no metal. The chartalist has no trouble in explaining them; they are the touchstone of his theory (303)."

for instance, as the Austrian State Notes of 1866 (Knapp 1905, 1).” It might be more accurate to say that Knapp is trying to build an empirical and scientific theory of money and means of payment in general, so that the gold standard might be defended more rigorously and have a functioning theory to argue on its behalf; Knapp even explicitly states that he is favourable to the gold standard: “I know no reason why under normal circumstances we should depart from the gold standard (Knapp 1905, 1).” The notion of Knapp attacking Metallism for its advocacy of metallic standards¹⁹ and not its faulty explanatory power regarding the phenomenon of fiat money can be readily dismissed, Knapp (1905, 303) even says as much: “The Chartal theory does not dispute the historical and practical significance of metal; it gives metal its proper place. It was the bridge to chartality; and it is still an auxiliary of exodromy²⁰, though not the only one.”

The question therefore arises: where does the value of money come from if not its explicit exchangeability for a defined quantity of metal? To understand what Knapp means by money, we have to first look at his treatment of means of payment. He divides means of payments into 3 separate categories: authylism, chartal payment, and giro payment. Rallo (2020, 775) characterizes these in the following manner:

Authylism is the primitive form of structuring payment before money appears, chartal payment is the means of payment that Knapp specifically denominates money (38), and the giro payment is the form of structuring payments that overcomes money (and makes it unnecessary) after money has already appeared.

Authylism can be understood similarly to direct exchange, meaning the exchange of goods and services without an intermediary means of payment. Giro payments are seen as a secondary MoE which, however, rely on chartal payments (money) and cannot exist without it. It is simply a layer of complexity in the form of the banking system built on top of money.

¹⁹ By necessity, because metallists do not consider anything else than minted coinage or commodity exchange certificates for metal money

²⁰ The term "exodromy" refers to the movement of currency from one location to another. Knapp is suggesting that metal served as an auxiliary or secondary means of exodromy, or the movement of currency, in addition to chartalism.

For Knapp the step from auctalism to chartal payments is an important one which needs to be made to allow for economic growth and specialization. The difference in essence between the two according to Knapp is that the former's validity is determined by "pensatory practise" - weighting the exchange-commodity to determine the exact quantity of units of value that are transmitted with the pay²¹- whereas the latter's validity originates from proclamation.

Proclamation, is the normative act of specifying "a piece of such a description shall be valid as so many units of value (Knapp 1905, 30)." The essential claim is that "Chartal means of payment derive their validity from the regulations under which they have been issued, not from the material with which they have been made (Rallo 2020, 776)." The value of the money comes from legal ordinances and regulations issued by the government and other authoritative institutions due to the trust and belief we invest into these institutions: the value we place on money is because of our respect of the government's fiat.

It is from this line of thinking that the fundamental claim emerges: "Money is a creature of the law. A theory of money must therefore deal with legal history (Knapp 1905, 1)." If the value of money comes from our implied respect of government authority and fiat, money must have originated from law, and to understand money we must study the history of such legal ordinances, legislations, and regulations which pertain to chartal means of payment.²² The indispensable role of central authority is nonetheless not merely limited to chartal means of payment but is also applicable to auctalism and giro payments. Their function is ultimately dependant on the administration of the payment system by providing a "counterparty against which to offset claims (Rallo 2020, 778)." The central authority has "a

²¹ (Rallo 2020, 778). Also see pages 28-30 in Knapp's *State Theory of Money*

²² "Chartality rests on a certain relation to the laws. It is, therefore, impossible to tell from the pieces themselves whether they are chartal or not (Knapp 1905, 34)". Knapp is saying that we must study the laws themselves because money is a mere manifestation of these laws and studying monies instead of the laws that produced them would be akin to studying symptoms instead of causes.

[potential] counterclaim against the holder of the means of payment, thereby offsetting both (155).”²³ In the words of Knapp (1905, 157):

As we said at the beginning of this book, the whole world of payments is a creation of the law; to this we now add the words "of the law in State or private pay- societies." Shortly stated, this proposition runs: The world of payments is a phenomenon of the administration. The administrative phenomenon, which we call payment, is most intimately bound up with the concept of the unit of value which has developed in societies, and cannot be thought of without this concept; but it is quite possible to have a world of payment without authylism, without hylogenic money, even without autogenic money or any money at all. Business payments, however, are not possible without some arrangement for transferring units of value; and Giro business seems to be the final conceivable form of it.

There is however one caveat to Knapp’s Chartalist theory. It is a theory relevant to the contemporary paradigm, one where the role of government is dominant and crucial, causing its laws to be paramount and vital to money. In Bonar’s (1922: 39) words: “In a century when absolute sovereignty is challenged on all sides, [Knapp] contends that the fiat of the ruler decides what shall be the money of the country.” Knapp’s theory of Money is not universal in that sense, but it is clear that he concludes that in the early 20th century, that which is giving money its value is the proclamation and fiat of state governments.²⁴ In the words of Knapp (1905, 53):

“The theory of the chartalists which we have here explained has room both for material and for non-material money. It is perfectly harmless, as it recommends nothing, and perfectly adequate, as it explains everything.”

²³ The administration of authylic, chartal, and giro payments are all differ “In a certain way, we could say that Knapp characterized authylism as the means of payment of the past, chartalism as the means of payment of his present, and giro payment as the means of payment of the future.”

²⁴ Knapp’s theory does not state that the central authority can be occupied by other institutions than the state, but any “administrative center of any organized pay-so- ciety can occupy such a position (for example the clearing office of a community of bankers).” (Rallo, 2020, 778)

Mises and Knapp compared

Though Mises does not accept Knapp's arguments on the origin of money, they are by no means necessarily incompatible. von Mises (1949, 404) says as much:

It is necessary to comprehend that one does not contribute anything to the scientific conception of human actions and social phenomena if one declares that the state or a charismatic leader or an inspiration which descended upon all the people have created them. Neither do such statements refute the teachings of a theory showing how much phenomenon can be acknowledged as the "unintentional outcome, the resultant not deliberately designed and aimed at by specifically individual endeavours of the members of a society."²⁵

The Austrian aetiology of money stresses an important nuance that solves the problem of fiat money. It is not the intrinsic properties or uses of the commodities -that are used as mediums of exchange or to back certificates- that give them value, rather it is the knowledge or belief in the ability to use that good in exchange with other individuals. In *Human Action*, Mises defines a medium of exchange as "a good which people acquire neither for their own consumption nor for employment in their own production activities, but with the intention of exchanging it at a later date, against those goods which they want to use either for consumption, or for production (Mises 1949, 398)." One could conceive of fitting the Chartalist theory into this framework without inherent contradiction. However, Mises points out that the notion that the "proclamation" of the state caused people to adopt certain media of exchange is not certain, and its refutation is "the task of historians."²⁶ Mises' proposed aetiology of money is one where the individual actors in a society simply realized and captured the gains of indirect exchange. One could imagine that most individuals who reside under the rule of a government, would view the reliability and security of a MoE more favourably if that government would endorse it. In the Austrian view, there is a demand for money, that demand being entirely subjective. Yet there are objective factors, such as law and legislation, which impact our subjective valuation of an economic good; they can affect how

²⁵ See also, Cf. Menger, *Untersuchungen*, 1.c., p. 178

²⁶ Mises 1949, 404

we value money. It is conceivable in the praxeological view, that if a government has enough authority and is respected by its populace, its proclamation can create the value of money.

However, this is not because the institution of government has some inherent proclamatory power, but rather because in a specific context individuals value and assess things in a certain way. In Mises' (1949, 403) words:

The praxeological method traces all phenomena back to the actions of individuals. If conditions of interpersonal exchange are such that indirect exchange facilitates the transactions, and if and as far people realize these advantages, indirect exchange and money come into being. Historical experience shows that these conditions were and are present. How in the absence of these conditions, people could have adopted indirect exchange and money and clung to these modes of exchanging is inconceivable.

The difference in their assessments of the role government in the value of money can be seen as consequences of their methodology. Mises writing on the origin of money starts from his praxeological assumptions and uses his theory of human action to deduce the development of money and its reason. His story of the aetiology of money is not a historical one, but a theory of the main principles and laws that guide the development of MoEs. Mises (1949, 403) himself says as much:

The historical question concerning the origin of indirect exchange and money is after all of no concern to praxeology. The only relevant thing is that indirect exchange and money exist because the conditions for their existence were and are present.

Knapp's story is, to a degree, one of a historical nature. The 4th chapter of *the State Theory of Money* consists of a monetary history of several European countries. Knapp's work, though not adherent to hardliner Schmollerian principles of empirical primacy, still continues the tradition of the historical method. It does not start with first principles built on truisms as in Mises' case but is inductive and based on historical knowledge and cases. Though there is theory, it is based on historical data. Moreover, he considers it "acatallactic"²⁷ because it

²⁷ Mises calls Knapp's Chartalism an acatallactic theory of money in the appendices of *The Theory of Money and Credit*: "Another acatallactic doctrine seeks to explain the value of money by the command of the state."

doesn't base the value of money "on the estimation of commerce (Mises 1912, 506)."²⁸ The catallactic theory of money stands in stark contrast as described in *Human Action* by von Mises (1949, 407):

It traces the specific exchange value of a medium of exchange back to its function as such a medium and to the theorems concerning the process of valuing and pricing as developed by the general catallactic theory. It deduces a more special case from the rules of a more universal theory. It shows how the special phenomenon necessarily emerges out of the operation of the rules generally valid for all phenomena. It does not say: this happened at that time and at that place. It says: this always happens when the conditions appear; whenever a good which has not been demanded previously for the employment as a medium of exchange, begins to be demanded for this employment, the same effects must appear again; no good can be employed for the function of a medium of exchange which at the very beginning of its use for this purpose did not have exchange value on account of other employments. And all these statements implied in the regression theorem are enounced apodictically as implied in the apriorism of praxeology. It must happen this way. Nobody can ever succeed in constructing a hypothetical case in which things were to occur in a different way.

This difference in methodology between the foundations of chartalism and catallactics is essential to explaining the different conclusions. Yet there is another component to the apparent disagreement that we would be wise to consider: definitions. The term "money" does not have the same meaning across the two theories. Money for Mises, who based his definition on Menger, is the generally accepted MoE, whereas for Knapp money is a chartal payment, meaning its value has to by definition be proclaimed by an administrative or political authority (which usually is the state). When we consider this terminological difference, Rallo (2020, 786) notes, the two ideas seem a little less distant:

And, as we have already studied, Knapp did recognize that certain types of means of payment could arise without any political authority involved. Specifically, he thought that authylism was originally borne out of custom, thereby creating "an institution of social intercourse" (Knapp [1905] 1924, 3).

Based on this careful treatment of definitions, it is correct from the chartalist perspective to say that it is possible that authylism could emerge without a central political authority being

According to this theory, the value of money rests on the authority of the highest civil power, not on the estimation of commerce. The law commands, the subject obeys (Mises 1912, 506)."

²⁸ The content of the Appendix A was originally published as a journal article in 1917-18 and used as a chapter in the 1924 German edition of *The Theory of Money and Credit*. In the Bateson translation of 1980, it was relegated to the Appendices. As a result, this part of the book is written with knowledge of the events of World War I and the post-war Weimer Hyperinflation.

involved. That is to say, exchange-commodities (commodity money in Austrian terminology) which were widely used, and accepted means of payments (MoEs) could emerge spontaneously in a Mengerian evolutionary sense in a society. Knapp, therefore, when interpreted carefully, does not necessarily disagree with the aetiology of money Menger and Mises propose up until a certain point: the advent of chartal payment. The conflict between both theories should consequently be viewed as more nuanced and complex, and not reduced to a simple binary disagreement.

Mises on Knapp's Scholarship, Chartal Theory, and influence

In the aforementioned appendix A, Mises classifies relevant monetary theories, ranging from those of Schumpeter to Wieser. Yet the main theme throughout all of the writing is the treatment of Knapp and his ideas. As previously mentioned, Mises saw Knapp's writings as "acatalactic" and explanatorily impotent, emphasising their inability to explain contemporary phenomena and their ignorance of other monetary paradigms. Mises highlighted that the applied scholarship by Knapp and his disciples on the monetary history of countries was fruitless and exposed the inadequacies of his theory:

That the new state theory did compromise itself immediately it was put forward, was due to its unlucky attempt to deal with currency history from an acatalactic point of view...All of these accounts [on currency history] are purely formal. They endeavour to apply Knapp's scheme to the individual circumstances of different states. They provide a history of money in Knappian terminology. There could be no doubt of the results that were bound to follow from these attempts. They expose the weakness of the state theory. (Mises 1912 [1934], 508)

In his estimate a real and consequential outcome of the state theory was that its popularity in the German speaking world caused more important ideas and theories to be disregarded and dismissed. That an acatalactic theory gained such notoriety was due to its impromptu alliance with *etatism*, as the state theory could be interpreted in a politically convenient

manner.²⁹ This mixture of etatism and chartalism lead to it “becoming the accepted doctrine in Germany, Austria, and Russia. This school had struck out catallactics, the theory of exchange and prices, as superfluous from the series of problems with which economics was concerned (Mises 1912 [1934], 510).” This new “school” that emerged as a marriage of convenience between chartalism and etatism effectively became the new dominant paradigm in the German speaking world, thus effectively succeeding the place of Schmoller’s historical school. It attempted to reduce the phenomena of society into the mere “emanations” of political authorities and their exercise of power. To Mises, the dominance of the chartalist theory in economics did not mean the imprudent and thoughtless adoption of a bad monetary theory, but the delusion of calling what is not a monetary theory in any sense just that.³⁰ It was a grave blow to any serious economist in his mind.

The chartalist scholarship on the history of the theory of monetary economics also comes under intense scrutiny in Mises’ writings. *The State Theory of Money* and other chartalist writings make little refined reference to other monetary theories, instead focusing on a strawman in metallism. Mises points out the absence of any discussion of thinkers such as “Bodin, Law, Hume, Senior, Jevons, Menger, Walras, and everybody else (Mises 1912 [1980], 517).” The strawman of metallism in Knapp is set up “as the general opinion on money (Mises 1912 [1980], 520),” and is based on mischaracterizations of the writings by Knies and Hermann. Knapp’s metallism is not a coherent school of economic thought, as Mises points out that it “is not amongst the economists that we must seek the metallists (Mises 1912 [1980], 521).” Moreover, Knapp does not make any references in his characterization of Knies and Hermann, furthering the confusion as to exactly what

²⁹ Mises notes (1912 [1980], that “Knapp writes for the German public of the present day, which under the influence of the etatistic version of political economy, acquainted only with acatallactic theories of money.” Consciously or unconsciously, Knapp is catering to the etatists in his writing.

³⁰ “The state theory is not a *bad* monetary theory; it is not a monetary theory at all (Mises 1912 [1980], 510).”

academic doctrine he is attacking. Suggesting an answer to identity of these “metallists”,

Mises (Mises 1912 [1980], 521) says the following:

In fact the metallist Knapp has in mind is none other than Knapp himself; not the Knapp that wrote the *The State Theory of Money*, but the Knapp that “disregarding all theory,” as he himself testifies, used to lecture on the “pragmatic” of the monetary system; the Knapp that, as one of the standard bearers of historicism in political economy, had thought that a substitute for thinking about economics could be found in the publications of old documents.

Mises’ critique is a harsh one that does not have enough justification to be blindly accepted, however it points to a broader failure by Knapp as a scholar to engage with contemporary and past ideas and thinkers in economic theory.

These theoretical shortcomings of chartalism were according to Mises, consequential and nontrivial. The 20 years following Knapp’s publication of *The State Theory of Money* saw dramatic monetary phenomena unfold in the German speaking world, most notably the inflations of WWI and 1921-23.³¹ During those events Mises notes the silence of many chartalist academics, and their consistent inability to give a coherent explanation of these events: “On all the important questions of monetary policy that have arisen since 1914, the followers of the state theory of money have maintained silence...they have not been able to say anything on the problems that occupy us nowadays (Mises 1912 [1980], 510).” The deficiencies of the state theory however were not limited to theory alone, but also had consequences in policy. There is no talk of the connection between money and prices, particularly how the quantity of money affects prices. This translated into substantial results in economic policy due to the state theories wide adoption³², the most substantial of which being the monetary policies conducted by Germany in the periods from 1914-1918 and 1921-23. The common thread throughout both periods is the considerable negligence of the inflationary consequences of monetary expansion due to the belief that as long as the state

³¹ Colloquially referred to as the Weimar hyperinflation

³² Mises notes that the “majority of those now at work in Germany on monetary problems base their history of theory entirely on Knapp (Mises 1912 [1980], 524).”

“proclaims” the value of the currency to be a specific amount, it will remain at that amount even if the quantity of notes is increased. These consequences cannot solely be attributed to Knapp, however his ideas and the manner in which they were espoused certainly were of a causal nature to the monetary events in the period described; Mises (Mises 1912 [1980], 510) affirms as much when he says that “to ascribe to the state theory a large share of the blame for the collapse of the German monetary system, does not imply that Knapp directly provoked the inflationary policy that lead to it.”

Conclusion

Mises’ and Knapp’s works represent the two leading stories in the post-historical paradigm of German speaking economics. Knapp’s theory found widespread acceptance in Germany during the First World War and the early interwar period. This is in large part due to politically expedient interpretation for the administrative leadership and its suitability to the general climate of etatism prevalent in Germany at the time. The consequences of his monetary paradigm, and its negligence of core questions surrounding the relation between money and prices had severe and very real political and economic ramifications in the shape of the inflation Germany experienced between 1914 and 1923.

However, in endeavouring to understand Knapp’s chartalism, it is plain that it is attempted positive theory. Any normative claims made through policy suggestions on the basis of chartalism, be it by etatists of the early 20th century or contemporary supporters of MMT, are not supported by Knapp. Yet thinkers must, to some extent, be held accountable for the flaws in their ideas and the consequences that ensue. That the state theory gained such notoriety at the expense of catallactic theories can be understood as a consequence of the former’s political expediency; it showcases the dangers of a marriage between politics and economics. Knapp and Mises highlight the

importance of economic theory in society and prove that it does not simply exist in an academic vacuum with little impact on the world. We see the magnitude of supposedly harmless theories and how they grow to shape our world. Economic theory is alive in the very sense of the word. Ultimately, *The State Theory of Money* should be viewed as a cautionary tale that when theories are flawed, they can cause nothing short of catastrophe.

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