

JESÚS HUERTA DE SOTO:  
ARTISAN OF NEW HORIZONS  
ON THE ORIGIN OF ECONOMIC  
CYCLES AND CRISES

(Review of Jesús Huerta de Soto's book  
*Bani, credit bancar și cicluri  
economice*, published in Romanian  
by the «Al. I. Cuza» University Press  
in collaboration with Ludwig von Mises  
Institute, Bucharest, 2010, 853 p.)

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I  
WHO IS THE AUTHOR?

An anniversary such as the one by which «Al. I. Cuza» University celebrated 150 years since its foundation can be emphasized and remembered in many ways. In our opinion, it would be proper to draw attention to the existence of some seminal works in world knowledge. The University of Iasi celebrated its anniversary by translating and publishing the book *Bani, credit bancar și cicluri economice* by Jesús Huerta de Soto, reputed professor of Political Economy at the University Rey Juan Carlos of Madrid, Spain; «A professor of a rare talent, a scholar of an extremely wide intellectual horizon and with a deeply analytic capacity, and a writer who can make Economics to show as the best literary work, Señor Jesús Huerta de Soto ought to be named one of the last «Humboldtian» academics in the university field of economic

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science» —in the concluding words to the touching Laudatio by which the Spanish professor was rightfully awarded the title of Doctor Honoris Causa of «Al. I. Cuza» University of Iasi. We would like to underline that he is a professor with a fascinating scientific and academic carrier, with many valuable books, with a great intellectual tenure consumed in seminal issues and for the purpose of answering fundamental issues in economics.

Of all his scientific products, we stopped at one, a true «magnum opus», synthesis of the first main direction of research, monetary theory, banking and cycle theory, developed by professor de Soto in *Bani, credit bancar și cicluri economice*. First published in Spanish, in 1998, as *Dinero, Crédito Bancario y Ciclos Económicos*, according to the most experienced voices in the field, the work is one of the most complete, consistent and covering treaties on money, credit and economic cycle published in the literature of the field.

## II

### REASON FOR CHOOSING THIS BOOK

It is well known that many papers have been written on this topic, most of which are renowned ones. «Al. I. Cuza» Publishing House chose to offer the Romanian translation of this book based on solid arguments.

**First**, it is worth mentioning that the topic itself is in the pipeline and the book we are referring to has already become an *authority* in the field both in terms of *ideas* and *facts*. As far as the *former* is concerned, i.e. its acknowledgement by great minds that contributed to this field, we simply mention a few sequences. Up to the present, the book benefited from two English versions and translations in eleven languages. The core or thesis of the book was also the subject of a conference organized by Mont Pelerin Society in 1993 at Rio de Janeiro, an opportunity for the Nobel Prize winner, James Buchanan, to praise the theoretical debate on the central bank –free bank relation and the fractional reserve system clarified by professor Huerta de Soto. Many comments were made on the work and sides were taken by some of the most

reputed publications in the field. To summarize, as far as money, credit and economic cycles are concerned, professor Huerta de Soto is already an authority in the field and his book is a seminal one with universalist valences. With respect to the *latter*, i.e. facts, since 1997 to present the evolution of real economy and mainly the Asian financial crisis, but also the present world crisis confirms to the author, and not only to himself, the veracity of statements and forecasts outlined in the book.

**Second**, in our opinion, the authority of the book is strongly founded on *the theoretical basis of report*. The author makes no secret from claiming the origin of his ideas when he directly sends to the *Austrian School* — one of the most reputed and solid schools of economic thought in the world. Moreover, the author draws on the old sources of this school; he invites us to acknowledge the exceptional novelty of the scientific product of the *Salamanca School*; he invites us to reflect along with the learned Jesuit and Dominican monks on topics such as the role of entrepreneur in economy, the subjective dimension of value, the way to set the «right» price on the free market, the place and role of a healthy currency in financial stability or, last, on the profitable effects of free trade. The true Wien school that the author glorifies and fructifies, animated by masters of economic spirit such as Carl Menger, Eugen Böhm-Bawerk, Friedrich von Wieser, with their vision on subjective value, free competitiveness, currency calculus, capital and interest theory, etc. already represents the second theoretical register to which Huerta de Soto acknowledges his belonging. From Ludwig von Mises and Friedrich von Hayek who are also very present in the book, Huerta de Soto takes all and especially the openness, polyvalence, multidisciplinary and methodology. In this way, professor Huerta de Soto joins other reputed European economists such as Pascal Salin and Guido Hülsmann to give a professional and updated reply to the American version of the Austrian School that inspired him; from Murray Rothbard that put the ethic criteria at the foundation of politics and of the banking and monetary policy; from Israel Kirzner in making entrepreneurial approach a realistic source of analysis of economic issues. As brilliant follower of great professors, Jesús Huerta de Soto did not have another alternative than to write a *great book*. One can only think and write

properly based on such foundations when one draws on Menger, Böhm-Bawerk, Mises or Hayek, and when one is in direct competition with the brilliant North Americans Rothbard or Kirzner. Due to its drawing on such philosophers, the book is revealed to us as one of the most accomplished *synthesis* on the topic discussed; a synthesis responding to the integrative vocation which is specific to the Austrian School where the multidisciplinary approach is at case; where the micro analysis is subordinated to the macro one and vice versa; where nominal economy is caught in-between the texture of the real one; where, finally, economic, legal, historical, institutional, ethic, etc. dimensions coexist in the theoretical-doctrinary approach of some apparently «dull» issues such as money, capital, interest, economic cycle, accounting or banking practice.

The strong theoretical and methodological foundation of the Austrian School on which the professor's book lies on is a mark of seriousness, consistency and profoundness of analyses that become complete in this perimeter. But he is not the only one. A book written by an «Austrian» is also interesting because it offers a different perspective, by definition; it is, from the beginning, an alternative to «mainstream economics». From Huerta de Soto's writing, we found out the «opposition» to orthodox economic and political theory with respect to money, credit and economic cycle. However, no further explanations are needed to prove that it is convenient and useful to stop at a landmark book.

### III

#### WHAT DOES THE BOOK TELL US?

Professor Huerta de Soto's book is a thick one having the attributes of a *treaty*, not only by dimensions, but also by its analytical load. Moreover, it targets a wide readership. Students, researchers, professors, specialists in monetary and banking issues can cut their right «slice» from the book. In other words, the book is also appropriate for a partial reading, although it remains splendid on the whole.

It is not easy to present such a great work as the one herein in a few pages. By trying to find its essence, we believe that the author had at least three *aims*:

- Clarifying the traditional theory on money deposit agreements, and adjacent, the theory on money, bank accounts and economic cycles;
- Making a critical presentation of the financial-monetary system centered on and starting from the Central Bank as coordinating pivot; revealing the synonymy of such a system and prove, with arguments, that it does not stand a chance in efficiently using economic calculus and that, finally, it will collapse as any other social system, fruit of a social image;
- Building and presenting a new model of financial system applicable to a free society.

An *obsessive* question defines all these aims: «Why does Say's Law not apply in certain circumstances, recurrently and as a result of credit expansion?» Or, in other words, why is economic life cyclical and crises seem to be unwanted, yet permanent company? This is the fascinating story of a growth aiming at permanence, sustainability but which is painfully stopped for «human» reasons and needs to be restarted.

Jesús Huerta de Soto tries to give «another answer» to this question; one that keeps in line with the Austrian School of thought, but yet opposed to the official paradigm. In order to meet his objectives, he posits his analysis on three foundations spreading on nine chapters.

All the pages of the book are important for the logic of demonstration and most of them are quotable. We believe that the following deserve special attention:

- For the *1<sup>st</sup> part* (chapters 1-3):
  - the exceptional presentation of the theory on money deposit agreements and its dissimilarity with the (mutuum) loan contract;
  - the percussive historical study in which, based on a rich empirical basis, the banker's perverting process is revealed to us as he turns from a serious figure summoned by modern economy and history to the money lender and takes on his extortionate practices. Thus he becomes a criminal who breaks

the traditional principles on several officially acknowledged occasions only to allow himself to lend the sight money that were entrusted to him. Based on this foul process, we are initiated to the passage from deposit agreements with a reserve coefficient of 10% to the fractional reserve system. In this process, the concern for liquidity is transferred from the private bank to an entity with central-coordinating functions, also called Central Bank. Moreover, we find out, in context, about the theoretical poverty of the doctrinary attempts at justifying such practices (of fractional reserves) that, in the author's opinion, will keep their status of breaking the law.

- *The second foundation* (chapters 4-7) sends to the *core of the analysis*. In a critical manner, the author presents the main doctrines, i.e. *monetary* and *Keynesian*, that support the financial system with fractional reserve. Mainly considered to be two alternative theories, we find out from Huerta de Soto's book that monetarism and Keynesianism strongly interfere having the following *mutual gaps*:
  - The lack of a solid theory of capital able to explain the intimate relation between production structures and nominal ones. They are both criticized for operating with the mythical concept of homogenous and reproducing capital, a ground that produces revenue, a concept with no sustainability in real economy;
  - The compromise made by both doctrines to A. Marshall for misunderstanding two main issues:
    - a) Currency is not neutral; credit and currency expansion influences the production structures, not in a balanced and simultaneous manner as an «ebb», but in an unequal and disproportionate way as an «earthquake», leading to a bad allocation of resources in macroeconomic terms;
    - b) Prices influence costs and not vice versa (in this sense, the references to the well-known demonstration of P. Sraffa in *Production of Goods by Goods* is eloquent);

- They are both exclusively and intendently macro-economic. Hence, from an epistemological perspective, they are both facing the same obstacle: they see only macro ideas, instead of concrete intrinsically micro ones;
- They both take cause for effect suggesting the increase in the amount of money as remedy instead of readjusting real economy.

We especially and particularly mention a critical aspect for each of the two doctrines:

In the case of *monetarism*:

- The pure mechanistic vision of the quantitative theory of money rendered by the equation  $MV=PT$ ; a vision sustained by the belief in the existence of general levels of prices and relative structures with powerful influences causing distortions in the production structures.

In the case of *Keynesianism*:

- The Utopia of declared neutrality for the currency;
- The conviction to an accounting approach induced by the famous equation  $I$  (investments) =  $S$  (savings). The author insists on the sources of economies to draw our attention to the fact that  $S$  comes from money created out of nothing by a bank without any support in voluntary, normal savings and a correspondent in real life; therefore we have to expect distortions from the evolution of economy;
- The falsity of the correlation between the capital's marginal efficacy and the interest rate that we arrive at in the lack of a solid capital theory.

The author replies by imposing the vision of the Austrian School whose partisan he proclaims to be without any reservations; a School that feeds on the glory of the consistent capital theory as basis for understanding the cyclical evolution of economy; a theory based on which:

- Production is sequentially regarded by taking into consideration the time factor and the turning of goods from simple to high quality goods;
- Capital is inhomogeneous;
- Money has an active role and its circulation affects price structures;
- The micro-macro distinction is void and the two plans are two components intimately related in a network.
- Crises have endogenous causes; they mainly owe to credit expansion;
- Costs are subjective and determined by prices.

Chapter 8, with its special architecture and a unique significance from a normative-doctrinary viewpoint, is interposed between the second and the third part. The beginning *core* is fructified herein, the one that was the subject of an article the author published in France, in 1994 under the title «Banque centrale ou banque libre: le débat théorique sur les réserves fractionnaires». In this chapter, professor Huerta de Soto tells us *the story of Central Bank* as lender of last resort. He describes the historical process revealing to us that despite the intended aim, the Central Bank is not the result of a spontaneous process of social cooperation and hence of the functioning of free market mechanisms. On the contrary, it is *a created organization* as a result of the serious consequences that derived from the violence of the fundamentals in private law, following the suggestion of private banks that, once they lost their customers' trust, asked for support from the government. The latter gives its help in time by founding the Central Bank. In the meantime, the process mentioned above occurs, i.e. the concern for liquidity is transferred to the Central Bank so that private banks «fructify» capital as source from sight deposits. This is all based on «a degenerative system of law» according to which even the existence of the Central Bank seems to be a *dilemma* as:

- *Theoretically*, it was created to maintain monetary stability and impose a system of rules meant to throw credit extortionate practices into oblivion;



- *Practically*, the Central Bank makes most of its appearance and shows off in moments of crises. And in these moments it forgets its historical mission and in relationship with the state (government), also interested in «fructifying» the moment and in «self-financing», it fills the circulation channels with currency out of nothing, by issuing massive liquidities – a pretended salvaging remedy for dealing with the crisis. By taking such measures and putting itself in the position of lender of last resort, the Central Bank practically annuls its theoretically defined mission.

*The last part* which is the most exciting one is the *model* offered by professor Huerta de Soto as alternative to «mainstream economics» for economic cycles and crises. In his noble modesty, the author does not insist on the total originality of his *proposal*. He only pretends to have made a *synthesis* of what others said before him: Mises in *The Theory of Money and Credit, Monetary Stabilization and Critical Policy*; Hayek in *The Monetary Policy of the United States after the Recovery from the 1920 Crisis, Monetary Nationalism and International Stability or The Denationalization of Money*; Rothbard in *The Case of the 100 Percent Gold Dollar*; M. Allais in *Les conditions monétaires d'une économie de marche: des enseignements du passé aux reformes de demain*, etc. in H. Simons, M. Friedman and other theorists of the Chicago School, partisans (naïve partisans, in Huerta de Soto's opinion) of the system with a reserve coefficient of 100%.

Jesús Huerta de Soto's proposition may be summarized to three main sentences:

- a. The total freedom of choosing the currency. The privatization of the currency and the elimination of intervention from the part of the state and the Central Bank in the issuing process and monetary control are had in view. In other words, «a denationalization of money» is proposed as envisaged by Hayek. Technically speaking, the privatization of money by substituting it with its equivalent in gold or other monetary money standards.
- b. «Elimination of the Central Bank and of the other governmental organisms devoted to control and intervention on the financial and banking market».

- c. The respect of the reserve coefficient of 100% for sight or demand deposits.

*In short*, professor Huerta de Soto, as well as his predecessors on the idea, envisage a financial-monetary system functional in a completely free economy; an economy built by imposing and respecting a set of rules and a system of laws. Neither the author, nor the ones that inspired him were so naïve to see that there were too many powerful counter-weight forces interested in an economy that would not be perfectly free. Hence the critique against the government-state, incapable of restraining itself and intervene in the economic play. Hence the goal of the «toreador» professor Huerta de Soto to defeat the «bull» embodied by the opportunist figure of the Central Bank, appendix of the profiting and interventionist state.

#### IV MESSAGE OF THE BOOK

The general message of the book is a liberal one. The application of the theorem of the impossibility of socialism is an attempt specific to the Austrian School to prove that any social engineering, exclusively operational in the financial-banking system fails and finally turns against the population. In a liberal style, the demonstration is made with the tools and craftsmanship of a learned theorist keeping in line with the aristocratic scientific tradition opened once and for all by Mises, Hayek and Rothbard.

Professor Huerta de Soto's logical and captivating demonstration is received with difficulty. It is «against nature» and against the stream. Although it puts the nail on the head and points to the origin of the syncopes in economic growth, his pleading is scientifically accepted, yet opposed to mainstream ideology. Such a book ruins the mechanisms of official policy and science not interested in causes, but in temporary remedies. In this unfortunate state of affairs, the example of professor Huerta de Soto should be an exemplary one that is worth following in the necessary attempt to revive the tradition of the Austrian School;

this is as necessary as the law of science corresponds to the twin interests of banking agents and the state.

Jesus Huerta de Soto is professor of Political Economy. In other words, a «professional theorist», nourished by the sources of the best schools in the world and serious readings in economics and beyond. Such formation comprising knowledge of economy, law, history, philosophy, ethics or national accountancy allowed for his openness and span to develop; allowed him the perspective of a double analysis: from the inside with the tools of the specialist in economics; from the outside, with the mind of the scholar not belonging to any ideological dogma and free from the narrow traps of any «profession» on the large field of economic theory and practice. He tried and succeeded in telling us why we were always wrong in our attempts of permanent growth and we were forced to start again because he afforded an «outer» vision. A convinced keynesian, a monetarist or a practitioner in a bank do not have the chance to succeed in this way. Such a chance is only given to an established theorist such as professor Huerta de Soto.

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