

The Political Economy of Liberty and Money

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Introduction: The Foundation of Modern Liberty in the Monetary Economy

On 17 December 2010 a police officer in the small rural town of Sidi Bouzid in Tunisia confiscated the cart of a young street vendor named Mohammed Bouazizi. He sparked off a series of uprisings against autocratic regimes that swept the Arab world. The Arab Spring was a moment of hope for freedom and democracy. Yet, by mid-2012, the wave of initial revolutions and protests had faded. Many demonstrations were met with violent resistance from authorities, armies, pro-government militias, and counter-demonstrators who sought to maintain the old order. Soon the support for the freedom movement collapsed. Winter returned after spring.

The Norwegian Nobel Committee awarded its Peace Prize to Aung San Suu Kyi of Myanmar (Burma) in 1991. Praising her non-violent struggle for democracy and human rights, the Committee wished “to honour this woman for her unflagging efforts and to show its support for the many people throughout the world who are striving to attain democracy, human rights and ethnic conciliation by peaceful means.” A quarter of a century later, in 2015, Aung San Suu Kyi won a landslide election victory; Myanmar embarked on a path to democracy. But the initial hope and enthusiasm were short lived. In February 2021, the military took back power, brutally killing thousands of opponents.

In 1919, Germany adopted the Constitution of Weimar, which was praised as the most democratic constitution of the world. It declared that “the freedom of the person is inviolable” (art.114), “all Germans are equal before the law” (art. 109), and “the order of economic life must respect the principles of justice with the purpose of ensuring a dignified existence for all” (art. 151).¹ Less than 13 years later, hyperinflation had destroyed most of the financial wealth of the country, austerity had pushed unemployment to over 30 percent, justice seemed to be ignored, and the Nazis took over to establish one of the bloodiest dictatorships in history.

These three stories, and many other similar ones, pose a fundamental challenge to theories of human rights. How did authoritarian rulers find the assent by a sufficient part of the population to restore a rule that denies individuals their fundamental rights of liberty? And assent there is. Authoritarian rule is more than power and violence. All Revolutions, whether successful or failures, manifest a clash of two normative systems: one of submission to hierarchy, the other of individual freedom and equality. The dominance of the first represents the traditional, the second the modern world. Each reflects a different concept of liberty and human dignity. Benjamin Constant (1819) identified them as the liberty of the ancients and the moderns. The first emphasises the freedom of the collective in which individuals play a subordinated role; the second stands for freedom and equality among individuals who have

¹ <https://www.1000dokumente.de/index.html>

common human rights. In the first, dignity is defined by hierarchical positions in the community; in the second, it is a fundamental property of each human being.

The key question raised by this book is this: how was it possible to think what no one had thought before, namely that individuals are born free and equal?² This question has two dimensions: One is the normative foundation of modern liberty: what do we mean by liberty and what has caused the changes in its meaning? This is a question for social scientists. The other side of the question asks what is the mechanism that has diffused the norm. How was it possible that the new and modern meaning of individual liberty has become the dominant norm in many parts of the world while it has been rejected in others? This should interest policy makers, for only by understanding the foundations will it become possible to open the way for a world where liberty is a sustained fact and human beings can live in peace as free and equal individuals with their dignity intact.

In this book, I seek to develop a foundational theory of liberty. For without such theory we cannot understand, why so many attempts to overcome authoritarianism and install respect for human rights have failed; nor can we design strategies for promoting individual liberty. I will explore the conditions, which allow the shift from the ancient liberty in traditional hierarchical societies to individual liberty in modern rights-based societies. I will argue that the driver of this process is money. However, we will see that money only releases this transformative power when it becomes credit.

The preference for liberty

Three documents have shaped our modern understanding of human rights and liberty. The French Declaration of the Rights of Man and of the Citizen of 1789 proclaimed in article 1: "Men are born and remain free and equal in rights". The United Nations' 1948 Universal Declaration of Human Rights echoed that "all human beings are born free and equal in dignity and rights". The American Declaration of Independence also stated: "We hold these Truths to be self-evident, that all Men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and the Pursuit of Happiness....". Yet, there is nothing less "self-evident" than this truth.³ These statements

²Michel Foucault (1966) famously tells how reading a 17th-century text regarding an ancient Chinese encyclopedia made him rethink his own thoughts. His book, he writes, "first arose (...) out of the laughter that shattered, as I read the passage, all the familiar landmarks of thought—*our* thought, the thought that bears the stamp of our age and our geography—breaking up all the ordered surfaces and all the planes with which we are accustomed to tame the wild profusion of existing things and continuing long afterwards to disturb and threaten with collapse our age-old definitions between the Same and the Other." And he concludes: "the thing we apprehend in one great leap, the thing that, by means of the fable, is demonstrated as the exotic charm of another system of thought, is the limitation of our own, *the stark impossibility of thinking that.*" (Emphasis added). I believe that when we think about liberty, we encounter a similar limitation of our own system of thought.

³ In modern discourses it is often asserted that liberty necessarily implies equality of rights, and unless both liberty and equality are factual, human dignity is violated. Thus, liberty is part of a normative standard which is assumed *a priori* true, so that denying a part of it invalidates the whole. In the tradition of Kantian philosophy such statements are called analytically true or self-evident. See (Kant, Kritik der reinen Vernunft 1998). In other words, if individuals are not granted equal rights, they are not free, and if they are not free, they are deprived of their status of true human beings. Hence, whether one is free depends on whether all individuals

imply that the desire for liberty is something natural, something we are born with, grounded in the immutable nature of human beings. One could adapt Leibniz's reasoning on justice to liberty: "Justice follows certain rules of equality and of proportion no less founded in the immutable nature of things and in the divine ideas, that are the principles of arithmetic and geometry".⁴ But this is ludicrous. John Locke had already argued convincingly and at length that ideas are not innate.⁵ We are born with a biology that responds to external circumstances but that does not mean that we have an inborn knowledge of specific norms, laws, and principles.⁶ We gain this knowledge in the practices through which we adapt to our environment. Institutions sustain these practices by structuring the way we think - and money, I will show, is an extremely powerful institution that shapes how we think about liberty.

Liberty as a natural right or social choice

In the vulgar version of models of human rights, liberty is a natural right. People were born free and equal and have fought heroically and victoriously for their rights. They have innovated and experimented with different institutional forms for limiting the power of authorities; they have found, copied, and kept institutions that worked to preserve their liberty. In some cases, it took longer because the enemies of liberty were stronger and nastier, but ultimately liberty has prevailed - and always will - because it is natural.

This explanation resembles neoclassical economic models of public choice, where goods have utility which individuals maximize by picking what they like. From this perspective, liberty is a good that has utility. The preference for liberty is assumed stable in the short run, although tastes may change in a slow process over time (Stigler and Becker 1977). Free choice implies that individuals will also drop their liberty if other perspectives, such as security, have higher utility. This assumption enables consistent and rational intertemporal choices and can explain some institutional arrangements correctly. Unfortunately, it never explains what generates the *perception of liberty as utility* nor why preferences change. Economists leave the explanation of preference change to political theorists, but as Buchanan (1991) remarked, preference change theories still await their full integration into economic theory.

Grounding individual liberty in human nature, as the vulgar model of human rights does, will not do as an explanation. Too large are the differences between concepts of liberty between the ancients and the moderns; too embittered are the conflicts between cultures, which define liberty, equality, and dignity in radically different ways. Human nature allows an enormous diversity of beliefs. Philosophers from Hobbes to Rawls have deconstructed the view that human rights, and therefore modern liberty, derive from God or from human nature in His image. But then, what grounds the modern view? How did the norms of modern

have equal rights to act as they wish. The existence of liberty is then a matter of *fact*, which is either true or false, but not depending on the *validity* of the concept. In this book I search for the foundations of modern liberty, i.e., what made the modern norm of liberty valid.

⁴ Quoted in (Nelson 2004, 148)

⁵ (Locke 1975). See also: (Goard 1991).

⁶ David Ragazzoni has suggested to me to call this naturalist argument an "ontological argument and to distinguish it from the utilitarian argument. However, it will become clear later why the naturalist reasoning is just as epistemological as utilitarianism. I will therefore not call it ontological.

individualism become dominant? To find an answer, one must question the attachments to familiar doctrines.⁷ As long as one believes that modern liberty is the only acceptable form of liberty, it is impossible to understand how the ancient freedom of the collective could have turned into the freedom of individuals.

If freedom is assumed to be a “natural right”, the question is in what condition do human beings live “by nature”? Jean-Jacques Rousseau (1975 [1762]) famously wrote: “Man is born free, and everywhere he is in chains.” He did not claim to know how to explain this fact, but he thought it could be made legitimate. For Rousseau, freedom meant living in a state of nature characterized by compassion and the absence of greed, while civilizations were built on a social contract which deprived men of their natural liberty. By contrast, Thomas Hobbes thought that in the state of nature individuals would harm each other by their unconstrained freedom, although they were free to choose protection by the sovereign. John Locke subsequently recognized that the unfettered sovereign acting in the name of the collective was a threat to individuals’ life, freedom, and possessions, and needed to be constitutionally circumscribed. However, due to his methodological assumptions, Locke was insensitive to the pressures which communities exercise on individuals and which John Stuart Mill (1972) called the “tyranny of majority”.

If we reject naturalism, constructionism is an alternative. It is fashionable. According to this view, lawyers, philosophers, and other intellectuals have “constructed” discourses of individual liberty during the Age of Enlightenment. In a process of “copy and paste”, they invented complex discourses from more fundamental elements (Buckley 2005). However, this still begs the question why such “invention” did not occur earlier, why it emerged in the Age of Enlightenment, and most importantly why the discourse that we are born free and equal has become a universally accepted norm.

I seek to formulate a foundational theory for liberty. I believe that the assumption that agents have stable and well-defined preferences, possibly given by nature, is one of the greatest obstacles for understanding the modern ideas of liberty, equality, and human dignity. Liberty has many forms, and what it means to people reflects a *choice of society*, not a specific value. Political norms and preferences emerge with social practices. If we believe in the value of human rights, we need to discover which practises foster modern individual liberty. The use of money is fundamental in this respect. Ancient societies operated through principles of hierarchy. I will show that what distinguished the ancient from the modern economy, and ancient from modern liberty, was the practice of making contracts and the role money plays as a means of payment that discharges contractual liabilities. Commercial contracts were setting the norm for individual freedom, but the diffusion of this norm across the globe

⁷ One has to forget, so to say, who one is in order to find out who one has become. But how can we ever forget who we are? As Skinner (2002, 58) has pointed out, it will never be possible to study the past without bringing to bear our own expectations and pre-judgements. Hence, we must question our customary assumption and judgements. We can step out of our conventional certainties by formulating guesses, anticipations, tentative solutions to our questions and problems, hence by what Popper (2002) called conjectures. Accepting or refuting such conjectures depends on the evidence that they are true or false; or that they are valid if coherent and invalid if incoherent with an accepted set of norms. In other words, understanding the foundations of modern liberty is an epistemological enterprise.

depended on the emergence of the financial monetary economy in the 17th century and the universal claim to charge interest.

This argument requires quite a stretch of imagination. We will have to clear some basic methodological issues before we can see the trees in the wood. Explaining the preference for liberty is particularly challenging. What is the value of liberty? How come people think freedom is useful or preferable over something else, say security? And what about equality? Is equality randomly added to the norm of liberty, or is it intrinsic to it? A troublesome question is hiding behind the evidence: if all human beings are born free and equal in dignity and rights, why do they not always live in accordance with these principles?

The standard answer to the last question is that people lack freedom because they are repressed by power, fear, coercion, and violence. Evil rulers defend their privileges against claims for equality and suppress the ruled. Predatory elites resist the redistribution of income that would make them worse off (Acemoglu, D. and J. Robinson 2012, 84). There is obviously truth to that. As Mao Zedong said (and he knew what he was talking about): “Political power grows out of the barrel of a gun”.⁸ But we have to take a deeper look. How come, the powerful can exercise their power? Someone must give the order to shoot; someone must obey the order; someone must trigger the gun; and many must be watching silently. The ultimate explanation of such rule-following is that the fear of sanctions and punishment for non-compliance prevent people from rebelling.

Surrender to power requires the acquiescence by the suppressed, at least implicitly.⁹ This does not mean that everyone likes to be dominated, but that most people go along with it. They have reasons for doing so, and fear of punishment may be one of them, but the desire for security and order dominates. This is because effective behaviour in society requires individuals to coordinate their actions. To form mutually consistent expectations, people set up norms and rules. They hold these rules in their minds, which implies that they are aware of *how they ought to behave* and what the consequences are if they deviate from the norm.

Hierarchy and subordination are the most common rules for coordinating behaviour in communities. For ten thousand years and more, no one ever thought that people were born free and equal, or that individuals had rights. Individuals were granted privileges by the rulers that constituted *grant-rights*. Modern liberty, by contrast, consists of *claim-rights* which are constituted by a set of norms and rules in which all human beings are free to negotiate the terms under which they oblige each other. These terms define *individual* freedom-rights by allowing individuals to liberate themselves from the normative constraints of communities.

⁸ “Communists do not fight for personal military power (...), but they must fight for military power for the Party, for military power for the people. (...) It is very difficult for the laboring people, who have been deceived and intimidated by the reactionary ruling classes for thousands of years, to awaken to the importance of having guns in their own hands. (...) Every Communist must grasp the truth, ‘Political power grows out of the barrel of a gun’”. See https://en.wikipedia.org/wiki/Political_power_grows_out_of_the_barrel_of_a_gun

⁹ In a fascinating exchange with Judge Raveh, Adolf Eichmann declared in his trial in Jerusalem that all his life he had tried to live according to the Kantian imperative, but he was unable to act accordingly because he was bound by his oath to the Führer. See: <http://www.nizkor.org/hweb/people/e/eichmann-adolf/transcripts/Sessions/Session-105-04.html>. (Accessed 19.3. 2014). In the thought pattern of Nazis, surrender to the leader was more important than human decency.

Virginia Woolf (1937) once described modern liberty beautifully as “freedom from unreal loyalties”, namely from loyalties to nations, neighbourhoods, sex, teachers, schools, churches, ceremonies, etc. This idea underlies the concept of human rights, which has become the dominant normative discourse in global politics and a major standard of international legitimacy (Goodhart 2013, 2).

Hence, liberty is a mind state, a norm how people ought to treat each other which exists in their minds. Yet, fear of coercion and violence is a state of mind, too, and so is the freedom from fear. Power and putting up with it is never distinct from how and what people think. Hence, the acceptance of norms determines the structure of people’s interactions. Yet, the norms in people’s minds set the benchmark for acceptable social practices. If public stoning of women is admitted in some countries as a punishment for sex outside marriage, along with flogging for unmarried male offenders, this is not the deed of evil rulers, but a law that finds significant public support. Similarly, the Nazi state found many willing executioners (Goldhagen 1996), and most Burmese would agree that ethnic minorities are not their equal and Myanmar should be purged of the Rohingya minority. We need to understand how specific concepts of liberty become the dominant mind state for individuals living in society.

Norms and facts

Some philosophers have urged us not to confuse norms and facts.¹⁰ Norms are valid, facts are true. Liberty is only a fact when the norm is fulfilled. Hence, the validity of the norm is a necessary but not sufficient condition for factual liberty. The positivist separation of norms and facts requires that we assume the preference for liberty to be exogenously given. However, without explaining how the norms were constructed and how we came to believe that individuals are free and equal, it is impossible to understand how such claims have become valid. As Somek (2008, 271) put it: “Unless an answer can be given to the question of why an individual should want to have the desires that are important to his life as a whole, the individual cannot be said to be autonomous”. A desire for liberty that is determined by nature is incompatible with free choice and therefore a contradiction in terms.

However, most people are not interested in liberty as a norm, but in liberty as a fact. Yet, norms structure the world by setting the conditions that must be fulfilled for social facts to become reality. Accepting the norm lays the foundation for facts. Modern liberty makes a claim of *universal validity*. When the idea that we are all born free and equal is collectively accepted, it becomes a valid social norm, and all persons *know* what it means to be free and how to behave. They then endeavour to make the world such that it satisfies the norms and liberty becomes a fact.

Acceptance requires justification, which means providing reasons for doing so. Finding the reasons for which people accept the norms of individual freedom is the key question for

¹⁰ Hume insisted on the distinction between *is* and *ought*, and Moore (1993) coined the expression “naturalistic fallacy” for the amalgam when *ought* is derived from *is*. (Searle, How to derive “ought” from “is” 1964) has shown that this does not necessarily apply to social facts. However, the distinction is still influential with positivist science. For example, Milton Friedman (1953, 154) claimed, “positive economics is in principle independent of any particular ethical position or normative judgments”.

explaining the foundation of modern liberty. Hence, the foundation of liberty is epistemic, and our task is to explain how the knowledge of modern liberty comes about.

A norm defines how the world ought to be and norm deviation defines a gap that needs to be closed to make the factual world normatively consistent. The gap that interests us here is unfreedom, the lack of freedom. Rebels and freedom fighters employ themselves to close the gap, but they only succeed when they can generate general acceptance for the new way of thinking.

Clearly, unfreedom cannot exist without the existence of the norm that defines what freedom is. The same is true for equality; without the norm of equality, there is no inequality. This implies that only when the norms of liberty are *considered valid, i.e., generally accepted*, and firmly grounded in social practices, will it make sense to say that we are all born free and equal. This book is about how the normative foundations of modern liberty were laid; it is not about the gap between norms and facts. It is of course true that once a norm is accepted, the translation of the norm into facts requires organisational devices that aim at reducing norm-deviant behaviour. Examples for such organisations are governments, the police, judicial systems and procedures, etc. These organisations are not the object of my book. I wish to focus on what creates the acceptance of the norm of modern individual liberty.

How can the claim that we are born free and equal be justified? We may distinguish three reasons for norm acceptance. The first is logical consistency. If the normative discourses describe social practices that form a coherent system, it is reasonable to accept them as valid, because they are intellectually convincing. This is the Kantian justification of acceptance. However, when the norms conflict with other rules, it is impossible to accept them as universally valid; normative inconsistency will undermine general acceptance and the system will be corrupted.

The second reason takes a pragmatic utilitarian view and explains norm acceptance by instrumental rationality and systemic efficiency.¹¹ This approach interprets the validity of norms as conventions: we recognize norms as valid simply because it works for us to do so. In principle, any reason can justify adopting conventional norms as long as everyone follows them. For example, it does not matter whether road traffic is on the left or right side, as long as people stick to the rule. However, conventions work because they are generally accepted norms and how this acceptance comes about is what we seek to explain.

A major objection to these two kind of reasons is that they are dependent on cognitive and intellectual capacities of rational calculation (thinking logically, applying moral criteria, evaluating strategic options, etc.). In the complex real world, however, people quickly reach the limits of their capacity to work out whether it is reasonable to accept or reject a norm (Simon 1990). A third model, therefore, takes knowledge limitations into account. Being aware of their limited cognitive resources, individuals rely not only on their own experiences, but also on the opinion of others. In a vast process of group deliberation, they adjust their preferences and beliefs to what emerges as the most likely consensus of their group and

¹¹ For a critique of instrumental rationality see Habermas, 1981.

ultimately in society. Over time the probability of accepting a particular discourse as valid will converge. The mean probability that a norm is accepted, I call *stochastic consensus*.¹² It explains how individuals come to agree on the validity of discourses under conditions of bounded rationality. However, before I analyse how certain discourses become generally accepted, I must explain the difference between ancient and modern concepts of liberty.

The Liberty of the ancients and the moderns

The idea of modern liberty is radical and recent. Its acceptance was a revolution that had no equal, but there are still many places in the world where it is not understood as valid. Its foundation is part of a constructed culture, practiced in daily life, and not given by nature or authorities. It is based on norms that are articulated through discourses, and different discourses reflect different social practices. In traditional societies, the underlying norm for liberty is that the collective is *free from domination by outsiders*, but most people accept hierarchy and submission as the norm that governs their lives *within the community*. For them, liberty is encompassed in the “higher”, i.e., more universal, norm of preserving subsistence security and generating certainty of survival. Constant (1819) has called this the “liberty of the ancients”, by which he meant the freedom of the *collective*, the tribe, or the nation. By contrast, “the liberty of the moderns” is the freedom of individuals to define and choose their own life plans. I call that *political individualism*. Popper and Dumont spoke of *holism* versus individualism, a notion I will retain but I will emphasise its political nature and distinguish it from methodological individualism.¹³

Individualism is the *Grundnorm*, the fundamental norm, of modern societies. Coherent with individualism is the practice to make contracts freely, mainly in markets. In a contractual relationship two individuals meet and negotiate the terms of the contract. Each party is free to say yes or no, and this freedom makes them equal. This is the logical structure of contracts which generates the norms underlying individualism. Political holism means individuals subordinate their individual will to the community but they do this voluntarily. There are many reasons for accepting the norms of holism, but I shall argue that in the end they boil down to the fact that the solidarity of the collective protects individuals against threats to their survival and constitutes their imagined identity.¹⁴ This is highly relevant in societies living close to subsistence levels or when standards of living are threatened. This was true for ancient societies, as we shall see when we look at the emergence of democracy in ancient Greece, and it is true today, too.

¹² A stochastic system is one whose state is non-deterministic so that the subsequent state of the system is determined probabilistically. As a stochastic process, consensus evolves over time in a random, non-deterministic way, where the transition from one state of mind to the next is governed by a stochastic matrix of transition probabilities. This, contrary to many traditional social theories, notably Marxist historical materialism, I will explain the acceptance of norms as a random process where what matters are the transition probabilities.

¹³ See (Popper 1995). Dumont analysed holism and hierarchy first in (*Homo Hierarchicus. The Caste System and its Implications* 1980), then in (*Essays on Individualism. Modern Ideology in Anthropological Perspective* 1986). To be precise, I will distinguish between methodological and political holism and individualism, whereby political individualism determines modern liberty, and political holism the liberty of the ancients.

¹⁴ Identity has no substance. It is the mental construct of how individuals perceive how they ought to behave so that others relate to them with reasonably stable expectations. Thus, identity is a mind state, too.

Modernity and the diffusion of individual liberty depend on the process and degree of diffusion of individualistic norms. But even if the norms of individualism dominate in modern societies, elements of holism persist. For example, the hierarchy in the army or the bureaucracy of civil service or the insistence on national sovereignty derive from holistic norms. Dumont has therefore insisted that the distinction between political holism and individualism is not a strict dichotomy because both norm-sets always coexist in all societies; what matters is how they are combined and articulated. In a modern society, political individualism dominates over political holism. Because contracts are easily broken, the security of contracts requires a larger institutional framework. This is the function of the state as political philosophers like Hobbes and Locke had emphasised. Yet, institutional obstacles and vested interests may also hinder the diffusion of modern liberty. Deviations and gaps are unavoidable, but in the end social change depends on whether individualistic normative discourses are widely accepted. This approach paints a more differentiated picture of liberty than Constant. The modern idea that we are all born free and equal makes little sense in a holistic context of society, but even if the dominant norm is political individualism, holistic features must be integrated into the constitutional discourse of society.

We will study how the holistic norms and practices of traditional hierarchies were transformed by the practice of using money. The palatial societies in Greece, Egypt and the Middle East did not use money as a means of exchange, although they had sophisticated accounting systems. Before coinage was invented, there was no money and commercial relations were dominated by hierarchy. When in the seventh century BCE coinage was widely adopted in Athens (but not in Sparta), new liberties emerged. As I will show in Part III, coinage contributed to the emergence of the Greek *polis* and democracy. However, in ancient times, the expansion of money was constrained by the supply of silver and gold. Only with the financial revolution in 17th century CE when money became credit money, did the practice of contract-making start to grow systematically, thereby diffusing the norms of individual freedom and equality.¹⁵

However, there is a more general lesson we can learn. Today, so-called developing countries are in transition from holistic norms to modernity. They frequently operate with dysfunctional monetary and political institutions because the norms which define these institutions are incoherent and contradictory. The inconsistency appears in the form of corruption when money is used to sustain hierarchy; often it has led to violent revolutions and wars. In Arab Spring, in Germany's Weimar Republic, in Myanmar under Aung San Suu Kyi's government, the norms of modern liberty were not generally accepted. The beliefs and preferences of local people did not reflect the imported norms of international standards; they had become important, but not yet dominant.

When modernity is imposed from outside on a reluctant civil society, corruption, for which the story from Sidi Bouzid is exemplary, becomes wide-spread. Political instability as in

¹⁵ Credit did exist in Athens, but at a pre-normative scale. Many loans were interest free, although very high rates were charged for highly risky maritime loans, resembling risk sharing contracts in Islamic finance rather than modern credit contracts. In economies close to the subsistence level, charging interest was a sin, because it could push the poor below the subsistence level.

Weimar Germany and the popular support for xenophobia, racial discrimination, and genocide have similar foundations. Our foundational theory of modern liberty should explain how the conditions for accepting the norms of freedom and equality can be built.

Liberty and money

The modern view of liberty is not an abstract theory free of context; it articulates the normativity inherent in the social practices in markets. We shall see that commercial exchanges determine the contractual norm of freedom and equality, while financial contracts establish the interest claim which expands the normativity of contracts. This means, whether ancient or modern, liberty is grounded in specific social and economic practices, and it is the practice that sustains the normativity. However, because liberty articulates normative mind states that emerge from social interaction, it is not a set of principles which “need to be put into practice” like the recipe of a cookbook. Social constructivism must explain why theories, beliefs, and laws are accepted, and how this acceptance shows up in concrete practices.¹⁶ Rawls (1999 [1980], 307) explained that Kantian “constructivism holds that moral objectivity is to be understood in terms of a suitably constructed social point of view that all can accept. Apart from the procedure of constructing the principles of justice, there are no moral facts”. This is also true for the principles of liberty. Apart from the practices of interacting as free and equal individuals, there is no modern liberty, and we need to clarify what these practices are.

General acceptance and the constitution of institutions

The norms and rules that constitute social practices create institutions. An institution is a system of constitutive rules that create the possibility of structured and repeated human interactions.¹⁷ Money, markets, rights, and governments are all institutions. The continued existence of institutional facts requires that *a sufficient number of individuals* recognises and accepts the validity of the rules and by following them reproduces the existence of the institutional facts. Yet, what a sufficient number is has vexed political philosophers since Plato and Aristotle (Kendall 1941). With Kant (1998) we may call the content of institution-creating rules “synthetic *a priori*” norms because they consist of a combination of autonomy and individual freedom. Autonomy means what Searle calls “collective intentionality”, and individual freedom implies that one can “subjectively” disagree. When the two are aligned, a rule becomes objective. Kant ([1788] 1996, 81) derived the validity of such norms from their universality. However, *universality*, i.e., the condition that the norms are unanimously accepted by *everyone*, is not a necessary, but only a sufficient condition for the validity of the concept of modern liberty and the creation of institutions, including money and government.

¹⁶ To my knowledge, Hobbes was the first to become aware of this problem when he discussed the origin of laws. Hobbes is famous for having defended the absolute power of the sovereign, but his position was actually more subtle. In his last work entitled *A Dialogue between a Philosopher and a Student of the Common Laws of England* (1971) he distinguished between persons “who pen the law” and persons “who make the law”. He then argued, “it is not the word of the law, but the power of a man that has the strength of a nation, that makes the law effectual”. The mere declaration of a legal norm is not enough to constitute the origin of laws. It needs to be adopted by the formal consensus that gives power to the sovereign: “The King’s reason, when it is publicly upon advice and deliberation declared, is that *anima legis*; and that *summa ratio* and that equity, which all agree to be the law of reason, is all that it is, or ever was law in England...”. See also (May 2013, 93-99)

¹⁷ On institutions and institutional facts, see Searle (1995) and (2010).

The necessary condition is that the constitutive norms are *generally* accepted. By that, I mean that individuals accept the norms as relevant for the coordination of their actions, but they may have privately deviating preferences. They behave in accordance with what they know to be generally accepted. General acceptance means there is *tacit assent* (and tacit dissent) to behaving in accordance with the rules. I shall discuss the relation between unanimity and dissent when I explain the concept of stochastic consensus in the methodological Part II; we will find it again when we analyse the social contract in Hobbes and Locke.¹⁸

Three conditions generate general acceptance. First, norms, beliefs, preferences, judgments, etc., are mind states that we express by discourses. Discourses articulate the normative content of the principles of liberty such as political and civil liberties, the freedom to speak without fear of repression, non-discrimination, freedom from deprivation and poverty, the practice of one's faith or of marrying whom one loves, but also the freedom of markets or the constitution of democracy. These discourses define the concept of liberty *qualitatively*. They classify concrete acts into categories and assign them status functions, which describe their meaning and sustain social practices. By assigning status functions, discourses express speech acts that constitute institutions. We shall see that different forms of speech acts constitute different forms of rights and therefore shape the nature of liberty.

Second, the probability distribution of accepting specific discourses is the *quantitative* aspect. A generally accepted discourse must dominate the likelihood over other discourses to be accepted. This distribution reflects the stochastic consensus about liberty in a given society. Through a process of deliberation, communication, and mutual recognition of their practices, individuals will converge in their probabilities of accepting certain discourses. The emerging stochastic consensus enables them to coherently coordinate their interactions with others. Because their rationality is bounded, they do not only rely on their own experiences, but they also trust the judgments and knowledge of others. The trust reflects the probability of adopting the opinion of another person. This implies that the practices of other people will influence the probability of a person accepting a given discourse. Thus, stochastic consensus has three dimensions: the individual desires, subjective evaluations, and a social context which creates epistemic objectivity. It follows that if modern liberty is a norm practiced by making contracts, the acceptance of this norm is not confined to contract partners alone. Thus, discourses generalise the experiential specificities, and when they are generally accepted, their meaning is accepted and understood by everyone. Consensual discourses allow people to think the world in general and in universal terms.

Stochastic consensus does not imply unanimity, but simply that individual dissent diminishes over time as a result of deliberation and the noise around the common opinion gets reduced. *What appears as a common opinion are the statements with the highest probability of being considered valid.* However, while bounded rationality implies that people accept discourses that they cannot fully judge themselves, the probability distribution of individual mind states is not arbitrary. The need to coordinate individual actions within a group generates thought patterns¹⁹ that reflect the practices of individuals

¹⁸ For a discussion of Rousseau see (Collignon 2018).

¹⁹ Searle (1995) calls them *collective intentionality*.

in their daily lives. Now, if a practices such as using money and making financial contracts expands by crowding out hierarchical submission, then the likelihood of accepting the norms of individual liberty increases. The consensus in society changes. We then need to explain why social practices change.

The third condition for generating acceptance refers to practises. Shifting from ancient to modern liberty requires a change in the probability distribution of accepting the relevant discourses. The process of deliberation explains the epistemic foundation by which discourses get generally accepted, but if its content is not reproduced by social practises, the discourse would not persist and endure. Consensus needs an anchor in the experience of concrete practices. This is where the dynamics of money, credit and interest become crucial.

Money and the economic foundation of liberty

The economy is the set of practices that sustain a person's individual and collective survival. It involves a wide range of practices, including the reproduction of values, cultures, social organizations, political structures, legal systems, and natural resources. Specific ways of acting generate norms and the transformation of ancient to modern liberty requires social practices through which individuals experience themselves as free and equal. This experience is generated by the practice of making contracts.

Adam Smith (1978 [1776], 25) proclaimed all human beings have a "natural propensity to truck, barter, and exchange things". However, barter is a very primitive economic practice. It means exchanging goods for goods. Smith recognized that "money has become in all civilized nations the universal instrument of commerce, by the invention of which goods of all kinds are bought and sold or exchanged for one another" (1978 [1776], 44). I call this the *exchange paradigm* of money. From this perspective money is simply an efficient good that is exchanged for all others. As the pathbreaker for classical economics, John Locke considered that silver (and gold) was money and nothing else. However, this paradigm misses the fact that money is not only a means of exchange required to grease the wheel of trade, but also an asset that protects individuals against the vagaries of uncertainty over time.

The bridge between the flow and stock (asset) functions of money are financial contracts which are promises of future payment. A promise creates a contractual obligation, a debt, which is extinguished when the monetary asset is transferred from the debtor to the creditor. When a contract takes place "on the spot", it appears as a barter relation. There is certainty about the exchange taking place and comparing the utility of commodities is the only consideration that matters. However, the existence of money – and how it is created - makes the exchange practices in markets far more complex than the exchange paradigm recognizes. I call the alternative view, which combines the stock and flow aspects of money, the *contract paradigm*.

Schumpeter once said that there are only two theories of money which deserve that name, namely "the commodity theory and the claim theory" (Ingham 2004, 6). In his *History of Economic Analysis* (Schumpeter 1954/82, 56) traces these theories back to Aristotle and Plato. The commodity theory, which I call the exchange paradigm, treats money on the same footing

as any other commodity. Although this paradigm has been challenged by sociologists and anthropologists alike, it has remained the basis of classical and neoclassical economics from the early writings of John Locke, Adam Smith, Karl Marx, Carl Menger, and Ludwig von Mises, all the way to modern Arrow-Debreu general equilibrium models. The claim theory, on the other hand, which call the contract paradigm, interprets money as a means of payment that discharges debt claims. It can be traced back to Hobbes, Montesquieu, and the Banking School of the 19th century, and was elevated into high theory by Keynes' liquidity preference.

Money is of course necessary for the functioning of markets, but while in the exchange paradigm it serves primarily for explaining commercial transactions in the goods market, in the contract paradigm it also provides the foundation for financial markets. Important normative implications follow from these paradigms in economics. The exchange paradigm is based on utilitarianism. It is a sophisticated theory of greed for it only considers the satisfaction of wants. Individuals exchange goods because what they receive must have higher utility than what they give. The *homo economicus* is perceived as an isolated calculus machine. He does not stand in a social relation of claims, rights and obligations that free and equal individuals negotiate between each other.

The exchange paradigm is often used to claim that markets create freedom because people can buy whatever they want. This is an *ad hoc* statement without theoretical underpinnings.²⁰ Consequently, the normative violation when hierarchy interferes with markets and ancient holism corrupts modern liberty remains unexplained.²¹ Free markets are an ideal that never exists in its pure form and the foundation of modern liberty in the monetary economy remains hidden. I do not dispute that selfish interest and greed are powerful drivers for economic transactions, but I believe it is not the full story. What is missing is fear, which is just as much a motivation for asset management as greed.

The contract paradigm has a broader vision of self-interest, for it includes the protection against insecurity. It combines greed and fear as two joint economic drivers. This enables us to understand the foundation of individual freedom and equality in practices of the monetary economy. The contractual relation establishes two individuals as free and equal, because both sides are free to accept or reject the terms of the contract, and this freedom gives them equal status. This inter-personal relation is very different from the object relation on which the

²⁰ For neoliberals like Milton Friedman (2002), markets are the foundation on which freedom stands, because they allow people to make free choices. For North, Wallis and Weingast (2013) "thriving market economies also facilitate the stability of open access orders, democracy in particular, in a surprising number of ways. By studying democracy in isolation of markets, political scientists have missed these forces of political stability." However, the existence of markets alone does not explain how the norm of free choice could dominate social relations, unless one assumes that the desire for individual choice and modern liberty is determined by some nebulous "human nature"

²¹ Riese (2004, 178) made the point clearly: "The comparison of market and plan, or as often occurs, of the free market economy and the command economy, reveals a methodological short fall in that the market is by itself not able to secure cohesion in the economic system. It is rather the case that central planning alone or the uniform category of money can fulfil this function. There may be individual markets, but there is no overall market. It should be noted that this state of affairs is shown very clearly by the neoclassical theory of general equilibrium when it associates the market solution with the fictitious existence of an auctioneer who establishes the cohesion of the whole system."

utility of commodities depends. Like stochastic consensus, it is three-dimensional: an individual evaluates her desires for an object (a commodity) and transforms her desires into rational but subjective preferences. However, the acquisition of the object requires the contractual negotiation with another person. In a barter relation, individuals choose objects that maximise their subjective utility and they have no further obligations. In a contract relation, the promisor freely chooses to be obliged by making a promise. The obligation is not imposed. Those who accept a promise expect the promisors to fulfil their obligations and this constitutes their rights. Thus, the contract paradigm recognises that modern individual rights are claim-rights and not privileges granted by the sovereign.

The contract paradigm treats money in the context of debt contracts, either as the asset that extinguishes the contractual liability or because modern money is itself the liability of banks. Money sustains debt-based contractual relations that constitute the practice on which individual liberty is based. On the one hand, contractual partners recognise themselves as free and equal and this norm defines their dignity. But on the other hand, when money is credit, financial contracts also generate the dynamics by which the norms of modern liberty are diffused. The pivotal role of money therefore results from its function not only as *norm setter*, but also as a *norm diffuser*. These are two distinct dimensions which are determining our foundational theory of modern liberty.

When money was coinage, the exchange paradigm made sense because the practice of buying and selling appeared as an exchange of metal (silver and gold) against commodities. Aristotle (1939) described this clearly in his *Nicomachean Ethics*. The early monetary economy in the Greek polis, such as Athens, generated relatively flat hierarchies and rudimentary forms of individualism. However, their diffusion was restricted by the metal content of coinage. This changed with the emergence of long-distance trade and credit money in the Renaissance. When transactions and payments were spread over time, uncertainty emerged, for it was uncertain whether the transaction would be completed as promised. Fear of loss, risk aversion, and trust were important factors in the overall assessment of the utility of monetary transactions. Thus, the protection against uncertainty was and is an economic motivation very different from the acquisition of useful goods.²² Living in uncertainty is the primary natural state. Institutions reduce uncertainty by imposing rules on the otherwise uncoordinated behaviour of individuals. In holistic settings, the community provides security of subsistence, and people voluntarily give up their individual liberty in exchange. They may be free from fear, but this is not modern individual liberty. No one has described this more clearly than Thomas Hobbes.

In modern societies, i.e., after the abolition of usury laws, individuals are free to negotiate compensations for risk and uncertainty. Money provides security because it is liquidity and has purchasing power. As such, it has utility. The payment of money is proof that the conditions of a monetary contract are fulfilled, and this provides the security that a debt can be redeemed. The possession of money is therefore equivalent to the highest degree of certainty. The protection against uncertainty is no longer dependent on hierarchy but on

²² Of course, one can subsume the desire for certainty under the category of wants, but that turns the exchange paradigm into a tautology.

access to liquidity. I shall discuss in Part V the conditions under which modern money generated modern liberty in the 17th century in England. When these conditions are fulfilled, the utility of money consists in the reduction of uncertainty for cash-holders and financial contracts become the driver of modernity. Yet, giving up cash when buying goods or lending it out in the form of financial contracts is a loss of certainty, and the compensation for this loss of certainty is the interest payment. John Maynard Keynes has called the desire for security by holding money *liquidity preference*.

To see the logic how financial contracts become a norm-diffusers for individual liberty, assume that all money is credit made by the banking system and subject to the obligation to pay interest. Hence, the liabilities of the economy increase. If the economy borrows say 100 units of money and banks charge 10 percent interest, the system will be short of 10 units at the end of the credit period. The only way how paying interest can be ensured consists in borrowing more from banks because financial contracts stipulate the payment of money and not of goods. Hence, in an economy of credit-based money, the money supply must grow continuously, and the volume of financial contracts will increase as well. But the increase in the liabilities in the economy's balance sheet requires a simultaneous increase in assets to ensure that the economy remains solvent. This generates economic growth and therefore a larger volume of commercial contracts. Thus, the credit-based economy will gradually crowd out the ancient hierarchical command economy. In conclusion, it is the interest claim resulting from financial contracts made between free and equal individuals that promotes simultaneously economic growth and the diffusion of modern liberty.

[The transition to modern liberty](#)

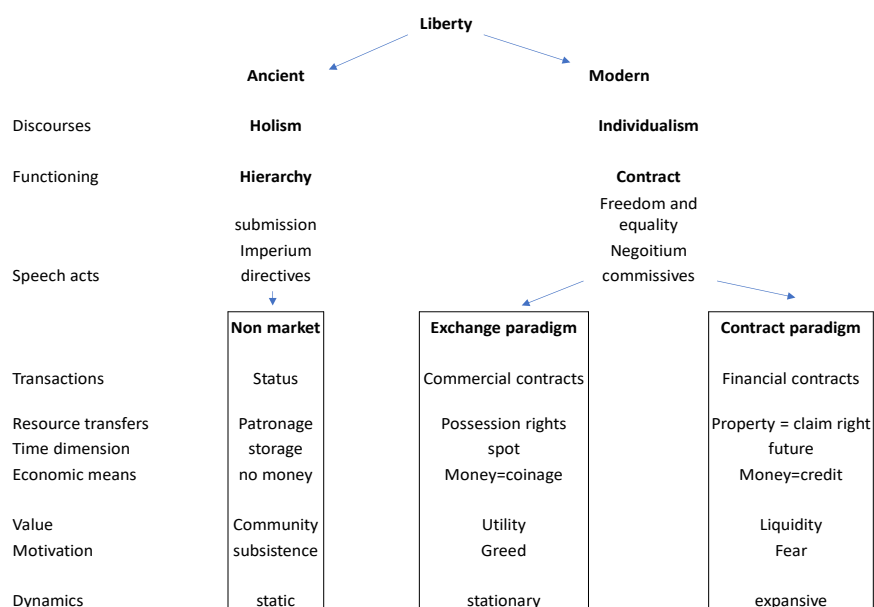
This analysis is highly abstract. Figure 1 summarises the logic of my argument. Discourses articulate the norms of ancient and modern liberty. They are based on different kinds of speech acts and discourses that define liberty. Ancient liberty is defined by political holism and social practices that allocate productive resources through hierarchy and commands. These principles are generally accepted because they provide security in an economy that operates close to the subsistence level.

Modern societies define liberty as freedom and equality for individuals who interact through contracts. Contrary to the assumptions of the utilitarian exchange paradigm, individuals in the contract paradigm are not isolated self-interested actors; they are not constrained by hierarchy and communitarian pressures. They interact in negotiated networks where they are free to choose whether to participate in social interactions or not, and this freedom makes them normatively equal. The speech acts which constitute modern institutions, including money, are not commands but permissives, i.e., promises. This means that rights are not created by commands that people must obey but claims that are potentially controversial.²³ The contract paradigm also restates the difference between property and possession which Roman law first articulated but was lost in medieval English common law. Taking account of this distinction allows the full integration of money into economic theory, rather than treating it as a handmaiden of trade and growth, and explains the foundation of modern liberty.

²³ See (Dworking 1977) for a discussion of the foundations of law.

The analysis of modern societies takes different forms in the exchange and contract paradigm. Both paradigms emphasise individual rights, but in the exchange paradigm they are possession rights granted by an external authority, while in the contract paradigm contractual claims generate rights. Because claims into the future are uncertain, credit carries interest and that expands the practice of making contracts. This practice propagates the norms of modern liberty and crowds out traditional holism.

Figure 1. The analytic framework



If my analysis of the foundation of modern liberty is correct, it has far-reaching implications for the promotion of freedom, equality, democracy, and human rights. The three cases presented at the beginning of this chapter represent situations in which the norms of modern liberty were challenging ancient holism, although these individualistic norms had not yet become dominant. My analysis implies that liberty could not be imposed on societies where the monetary economy is weakly developed, although the development of the monetary economy would propagate and diffuse the norms of modern liberty. Instead of norm *transfer*, the promotion of liberty requires norm *generation* by setting up a stable economic framework where contractual practices will develop, the norms of political individualism get firmly anchored, and claim rights crowd out hierarchy. Only in this context does it make sense to claim individual liberty, human rights, and democracy. However, we shall see that this is not a smooth and inevitable progression. Conflicts between individualism and holism are frequent in human history and often violent. Failed transitions to democracy are often rooted in unsuccessful financial developments.

What evidence supports our conjecture? History gives some clues. First, we shall see that moneyless societies before the invention of coinage around 600 BCE operated with steeply hierarchical systems in a command economy. I shall then discuss the transition from steeply

hierarchical palace-societies to the flatter hierarchy in small Greek communities and the role that money (coinage) played in the emergence of the Greek *polis*. The growing adaptation of coinage was driven by the slave trade in Athens after Solon's reforms. Coinage was consistent with commercial practices of exchange and communitarian forms of holism until the late Renaissance.

Political individualism and our modern concept of individual liberty only emerged when money became a means of payment in the long-distance trade of the Renaissance. Italian bankers relied on personal trust amongst each other. They started to circumvent the restrictive usury laws through the letter of credit and charged interest as the price for giving up the security of liquidity. This had two effects. On the one hand, providing security through finance became an alternative to the traditional submission of individuals into holistic communities. On the other hand, financial contracts promoted practices of contract making. The Financial Revolution in the 17th century introduced new economic practices into European society that developed the culture of individualism.

Modern liberty as a coherent discourse only developed in the 17th century in a climate of large uncertainties. During the Little Ice Age (1580-1720) uncertainty increased significantly and the development of trade, financial markets and colonialism were the response by English society to the threats of survival in the traditional agricultural society. New discourses on liberty flourished, of which Thomas Hobbes and John Locke are the most outstanding voices. Hobbes was familiar with the practice of making contracts from his work on the Board of the Virginia Company. Observing the emergence of autonomous individuals, he perceived that ancient holism was no longer acceptable and he sought a new foundation for the concept of political authority. He generalised the obligating norm of financial contracts to defend the absolute authority of the sovereign. Locke, who served on the Board of Trade and advised the Chancellor and the King on monetary reforms, opposed the political holism of the Tories and became the chief thinker for the new "liberal" Whiggish ideology, but the methodological foundation of his political philosophy remained holistic. He wrote extensively about money and counts among the first modern economists, but contrary to Hobbes, he was stuck with the concept of metallic money as a means of exchange. He identified money with coins and his monetarist recommendations in favour of recoinage in 1696 nearly brought down the new regime of King William III. Despite being a founding shareholder of the Bank of England, he did not realize the growing importance of credit money. Locke's political individualism therefore stood on weak foundations and this has been a genetic default of modern liberalism ever since.

While remote history is one source for insights on how modern liberty gained normative validity, shifts from political holism to individualism (and back!) are still occurring in our time. These experiences are another source of evidence for testing the model that liberty is founded on credit money. I will provide some econometric evidence in the last chapter.

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