The Gold Standard: A Critique of Friedman, Mundell, Hayek and Greenspan from the Free Enterprise Perspective[1]

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1. **Introduction**

This is an essay which takes as its jumping off point the free enterprise system. It then attempts to evaluate the contributions of four distinguished scholars to monetary theory in general, and to an evaluation of the gold standard in particular. I take for granted the general case for markets, competition, economic freedom.[2] The four individuals mentioned in the title have been chosen because they are widely believed to be exemplars of this limited government, free market, political philosophy - and are also opponents of the gold standard. It is one of the purposes of the present contribution to test that very proposition. To wit, it is an attempt to see how consistent with their otherwise expressed principles of free enterprise are their contributions to monetary theory.

Which monetary regime is consistent with the free enterprise philosophy? In order to answer that, we must first be clear on what is meant by this political economic theory. Laissez faire capitalism implies economic freedom and private property rights. As long as these are respected, a person may do whatever he wishes; there are no economic regulations, and government is limited to protecting persons and property through courts, armies and police. People are “free to choose” (Friedman and Friedman, 1980) within these legal constraints.

My argument is that the gold standard is the only financial arrangement compatible with such a vision (Mises, 1966, pp.471-478). This is because all that is meant by a gold standard are those monetary arrangements which are arrived at by freely choosing individuals. However, it is a matter of historical fact that whenever societies have been “free to choose” in this regard (Menger, 1950, pp.257-285), they have always evolved to gold.[3] It is for this reason that an actual misnomer has arisen within the field of economics: although “gold standard” would appear to imply that the yellow metal has something to do with monetary arrangements, this is not strictly true. In actual point of fact, the phrase “gold standard” now denotes whichever commodity emerges as money from the free interplay of market forces. For example, if silver, or platinum, or some other commodity were to have arisen as the money as a result of free market forces, there is not one advocate of the “gold standard” who would be disappointed; this is the case, because, literally, that is how the phase functions in our language: it refers to free market money, whatever its chemical properties.

This makes our quest at once more difficult and easier too. It is now simplicity itself to be able to declare that all those who oppose the gold standard (as defined above) cannot possibly advocate free enterprise, at least in this one field. This follows from the very definition. If all that gold standard *means* is marketplace money, and one opposes the gold standard, then one cannot without pain of contradiction assert that he favors the free operation of markets. But it is more difficult, too, if only for psychological reasons; opponents of this thesis will feel victimized by sharp practice; they will charge definitional legerdemain.

But there is no way out of this contradiction. The gold standard advocate means no more by this term than "free market money." The proof of this is in his warm embrace of any other metal (or commodity) which comes to be used as the money medium in the absence of any government compulsion. To be fair to the critics, however, we now turn to a careful consideration of their several objections to our thesis. We do not take up those emanating from Marxists, Keynesians, others self avowed enemies of economic freedom. Rather, we look at the critiques penned by scholars who are associated with this very same perspective. And not only are the four scholars mentioned above associated with it: they are seen by all and sundry as leading advocates, as foremost spokesmen, for economic liberty. All the more disappointing, then, that all four have rejected the market's choice in this regard, in favor of a panoply of idiosyncratic interventionistic monetary schemes.

2. **Milton Friedman**

Friedman (1960, p.4, emphasis added) starts out on a high note, fully justifying his leadership role in this field. He states:

> "The (classical) liberal is suspicious of assigning to government any functions that can be performed through the market, both because this *substitutes coercion for voluntary cooperation*, in the area in question and because, by giving government an increased role, it threatens freedom in other areas. Control over monetary and banking arrangements is a particularly dangerous power to entrust to government because of its far-reaching effects on economic activity at large - as numerous episodes from ancient times to the present and over the whole of the globe tragically demonstrate."

After ringing this glowing endorsement for monetary freedom, one could almost infer that he favors the gold standard. After all, he extols the virtues of the market and of free competition, and as we know, it was through this very process that gold "beat out" all other competitors. He forthrightly distinguishes between voluntary cooperation and coercion,[4] and this, too, implies the gold standard, the only monetary system which arose through the voluntary cooperation of the market.[5] Not content with merely a theoretical account of the virtues of the gold standard, Friedman seemingly buttresses his case with an empirical historical note, attesting to the tragic history of governmental (e.g. non gold standard) control. What more could be said on behalf of gold in so short a statement? Nothing at all.

In the event, however, we are sadly disappointed. For after so promising a beginning, our reasonable expectations that this is just the preliminary to a clarion call for market money is dashed to pieces. Says Friedman (1962, p.40, emphasis added):

> "The fundamental defect of a commodity standard (read gold standard) from the point of view of the *society as a whole*, is that it requires the use of real resources to add to the stock of money. People must work hard to dig gold out of the ground in South Africa - in order to rebury it in Fort Knox or some similar place. The necessity of using real resources for the operation of a commodity standard establishes a *strong incentive for people* to find ways to achieve the same result without employing these resources. If people *will accept* as money pieces of paper on which is printed 'I promise to pay - units of the commodity standard,' these pieces of paper can perform the same function as the physical pieces of gold or silver, and they require very much less in resources to produce."

This is very disappointing, to say the least. The argument as presented here in the two quotes above amounts to the following syllogism:

(1) a ringing endorsement of freedom

(2) a realization that this freedom will cost real resources

(3) the conclusion that we should not indulge in such freedom after all, since it costs something; instead, there is an option made on behalf of coercion, and we are in effect told to forget all about "substituting voluntary cooperation for coercion."

Let us assume for a moment, with Friedman, that freedom costs real resources, at least in the monetary field. This still does not logically imply anything like (3) the conclusion of his argument. For there are very different alternative resolutions of these propositions, which make at least as much sense as his own. For example, what about "justice though the heavens fall?" What has become of "our lives, our fortunes, and our sacred honors?" And where has gone "millions for defense, not a penny for tribute?" These, too, are equally valid as conclusions of the Friedmanite premises. That he has not taken up any of them is irrelevant to his skills as a positive economist, but speaks volumes in terms of his ranking of the importance of premises (1) and (2).

Nor need we resort only to philosophical notions of freedom. Even without these arguments, it still does not follow that just because a gold standard costs something, it is not worth it and should therefore be eschewed. Cars, houses and sailing boats all cost "real resources." Does this mean we should never buy them? Not at all. The usual ways such matters are settled is to consider their costs as well as their benefits.

What, then, are the values of gold as a money? Why should people pick it when they are "free to choose?"[6] Why should this be their choice when it "costs real resources," and there are all these cheap substitutes potentially available? To ask the question in this way is practically to answer it. They choose gold, they have always chosen gold, because even though it is more expensive[7], the credits derived more than make up for the debits. The advantages provided by gold vis a vis other commodity standards (malleability, portability, high value per unit weight and volume, etc.) are only the tip of the iceberg. Of far greater importance is its superiority when compared to fiat paper. And here the record is clear. Throughout history, and even in the modern era, millions of people have been victimized by governmental fiat currency inflation[8], even as Friedman has himself stated above.

The point is, gold is like an insurance policy. Just as locks, fences and doors are used to preclude losses from theft - even though they come only at the expense of real resources, so, too does the costly use of gold attain something desirable, namely, protection from statist monetary depredations.[9]

So far, we have been assuming the truth of (2). It is now time to call this assumption into question. Much to the contrary of Friedman's assertion, it is simply not true that a gold standard will be a debit, even in financial terms. Digging gold in South Africa and elsewhere, and burying it in Fort Knox or similar places takes place *anyway*, whether or not gold is the money medium.[10] This metal is a valuable commodity, and will be sought after whether or not it is used as money.[11]

Let us now address ourselves to several other problems with Friedman's analysis. First, from whose perspective is the choice of monetary medium to be made? Friedman presumably speaks "from the point of view of society as a whole." The obvious retort here is that from the economic perspective, only individuals choose, not societies as a whole, and whenever individuals have been free to choose, they have selected gold from amongst all market possibilities. Fiat currency, to be sure, has been *imposed* on societies, but never freely chosen.

The only interpretation of Friedman's remarks that is logically coherent is that it is not from the *economic perspective* that the choosing of a monetary system is to be attained, but rather from the political. If this is the correct meaning, then the truth of his statement cannot be denied. We did indeed choose paper money through the political system; it is undeniable that our democratically elected representatives chose to rescind the market choice of gold, and impose fiat currency in its place. But what does this have to do with freedom? Just because a majority of the people elected representatives who choose a certain path does not mean that this path enhances liberty. Indeed, one might go so far as to defend the very opposite thesis: that if a democratically elected government made a given decision - of any kind type or variety - it was probably counter productive to freedom.

Second, Friedman asserts that there is "a strong incentive for people" to find substitutes for gold money, since it costs real resources. We have seen the fallacy of the latter part of this claim, but the former is problematic as well. It implies that the masses of the people, through markets, prefer greenbacks to gold. In actual point of fact, though, such a decision was never made in this manner; on the contrary, this was imposed from above, politically.

Third, he talks of "people *accepting* as money pieces of paper on which is printed 'I promise to pay - units of the commodity standard'." But this is entirely ingenuous. Of course, they will accept a statist medium of exchange after legal tender laws require this, and after gold has been in effect outlawed as a money. But this is an entirely different matter than the one addressed by Friedman in the first (1960) quote above. There, he talks in terms of substituting coercion for voluntary cooperation, presumably allowing the decision as to the money substance to emanate from markets; here, he speaks of "accepting" paper as payment under a political regime which compels such behavior and prohibits alternatives.

Even more egregious, this statement is entirely compatible with the gold standard! For no one defines this institutional arrangement in such a way as to preclude people from carrying around in their wallets warehouse receipts for specific amounts of this metal. E.g. under a full robust 100% gold standard, people could still conduct business with checks, plastic credit cards, or folding money, or any other convenient substitute. The point is, all of these transactions would be *in terms of* gold; this metal would *underlay* all commercial interactions, even if its actual use is mainly implicit. Under this interpretation, Friedman is incomprehensibly attacking the gold standard by praising one particular aspect of it.[12] Thus, if all that is on his mind is the saving of resources, our economic freedom need not be pillaged in order to accomplish this task. All we need do is reinaugurate the gold standard, and content ourselves with the fact that various money substitutes will undoubtedly be employed as attributes of it, thus obviating the need for digging up excessive amounts of gold.

In addition to the fame he has garnered as an opponent of the gold standard, Friedman has taken a high profile in support of flexible exchange rates between different currencies.

In contrast, a full worldwide gold standard implies fixed exchange rates. In this scenario, the names of the national currencies indicate, merely, the different numbers of grams of the precious metal embodied in them. For example, the pound might be four grams of gold, the dollar two grams, and the yen one gram. If so, there is an unambiguous, totally "fixed" exchange rate between them all: the ratio of 4:2:1. That is, the pound is twice as valuable as the dollar, which in turn is worth two yen; and of course four yen trade for one pound.

It is sometimes objected that this would be akin to price control, where the price of one commodity is "fixed" in terms of another, or of money. But nothing could be further from the truth. The reason for the "fixity" in price controls is due to legislative enactments. If silver must exchange for gold at the rate of 16 to 1, this is because of unwise and invasive law, not any natural requirement. But a fixed gold exchange rate comes about for entirely different reasons. It is because the various national currencies are simply the names of different amounts of gold; the fixity, here, is engendered by this fact, not man made law. It is as natural as the fact that nickels, dimes and quarters trade at fixed rates with one another, that feet, yards and miles are all inextricably tied up with one another in fixed proportions. The former is clearly a violation of market freedom; not so the latter.

One problem with flexible exchange rates, therefore, is that they cannot be made compatible with a worldwide gold standard, which requires fixity, not flexibility. Another is that they lower the barriers against inflation. Gold, of course, is the inflation fighter par excellence. Since it is virtually impossible to counterfeit this metal, at least in the modern era, the stock of money under this standard is fixed, apart from new mine production. This holds true apart from this consideration. Even in the absence of a pure gold standard, fixed exchange rates provide some insurance against inflation which is not forthcoming from the flexible system. Under fixity, if one country inflates, it falls victim to a balance of payment crisis. If and when it runs out of foreign exchange holdings, it must devalue, a relatively difficult process, fraught with danger for the political leaders involved. Under flexibility, in contrast, inflation brings about no balance of payment crisis, nor any need for a politically embarrassing devaluation. Instead, there is a relatively painless depreciation of the home (or inflationary) currency against its foreign counterparts.[13]

3. **Robert Mundell**

How does Robert Mundell fit into the gold standard picture? Strictly speaking, he does not fit in at all. He is not particularly known for his views on this subject, and spends little of his intellectual capital on it. This is not to say he eschews it totally; on the contrary, his views in this regard are typical of most mainstream economists: he rejects the monetization of gold, contenting himself with attempts to bring greater accountability to a system that has long since been wrenched out of the hands of the market, and given over to the tender mercies of the political system. In his particular case he advocates the "gold price rule" which is similar, in effect and in intention, to Friedman's 3% "rule" for the fed. That is, it is an attempt to obviate government's natural tendency to inflate, without setting up a separation of money and state, as would exist under a pure gold standard. If this were all there was to it, he would not have been included in the present work.

The reason he is worthy of this dubious honor - apart from the fact that like the other three, he is noted for a general stance on behalf of economic freedom - is his work in the the-

ory of optimal currency areas (Mundell, 1961).[14] That is, the question of what geographical zone is appropriate for each type of money.

In his view, the "optimal currency area" is not the whole world. On the contrary, it encompasses far less territory than that. Right off the bat, that puts him in conflict with the gold standard view, which of course sees the optimal currency area for gold as the entire globe. Thus, not only should not the world be on the gold standard for Mundell, it should not operate on the basis of any one currency, no matter what it is, whether or not it is gold. We need, in his analysis, many currencies. But not competing ones, the Hayekian perspective. Instead, each one should be supreme, without its own area.

How does he arrive at this conclusion? He starts off with an initial assumption of full employment and equilibrium in the balance of payments. Then he posits a shift in demand, say from country B to country A (Mundell, 1961, p.658). In his Keynesian model, this causes unemployment in B and inflation in A.[15] As a result, there will be a flow of funds from B to A; B will be in balance of payments deficit, A in surplus.

To correct unemployment in B, there should be an increase in its money supply.[16] But this would aggravate inflation in A. So slower or zero monetary growth is indicated there. Or, best of all, a fall in the value of B's currency, and a rise in that of A's.

To the unreconstructed Keynesian, this represents no problem at all. With their keen insights into the workings of macroeconomics, money manipulation, fine tuning, flexible exchange rates, all is solved.

Now suppose that the world consisted of only the US and Canada (Mundell, 1961, p.659). Again, Mundell posits a situation of initial full employment, and balance of payment equilibrium, this time between the different regions of the two countries. As before, he then assumes a shift in demand. This is not from one country to another, but rather from goods produced in the western part of both countries to goods produced in the east.

The analysis flows along familiar channels: as a result of this demand shift, there will be unemployment in the west, and inflation in the east. There will be a flow of bank reserves from west to east. The west will be in (internal) balance of payments deficit, the east in surplus. To correct unemployment in the west, an increase in the money supply would be called for. But this would just exacerbate the inflation in the east. Unlike the previous case, there is no solution for Mundell. Except, that is, if currency is tailored to regions which are economically significant, not nations, which need not always be. To wit, there is a solution if the east and the western zones each have their own separate currencies. Then, the twin scourges of unemployment and inflation can be solved as they were before, through the use of monetary and fiscal policy and flexible exchange rates.

Having presented this model, let us now consider a few of its drawbacks. First, how is the region to be defined? Mundell does this in terms of a place within which there is factor mobility, and outside of which there is none. But regions so defined continually change.[17] That is, relative prices, new discoveries, innovations, the supply and demand of complements and substitutes are in a continual flux in the real world. If there are to be separate currencies for each region, and the regions keep changing, the implication would appear to be that the currencies, too, should continually be altered. This, however, appears more as a recipe for chaos than a serious suggestion for a new monetary policy.

Further, in one sense government is the main or only source of factor immobility. The state, with its regulations, required specifications, "buy local" requirements, licensing arrangements - to say nothing of explicit interferences with trade - is the prime reason why factors of production are less mobile than they would otherwise be. In a bygone era the costs of transportation would have been the chief explanation, but what with all the technological progress achieved here, this is far less important in our modern "shrinking world." If this is so, then under laissez-faire capitalism, there would be virtually no factor immobility. Given even the approximate truth of these assumptions, the Mundellian region then becomes the entire globe - precisely as it would be under the gold standard. (Here factor immobility is being defined as essentially government prohibition on trade).

There is an entirely different sense of factor mobility, however. Lying at the opposite end of the spectrum from the previous one, here it consists of the fact that costs (mainly transportation costs) render factors immobile, geographically. Based on this assumption, each individual person would have to be defined as a separate region. This is so because by definition he is the region within which there is mobility, and outside of which there is none. What is the implication of this second model? If there are supposed to be as many different types of currencies as regions, and if each person is a region, then there would have to be as many currencies as there are people - a separate type of money for each person. The problem with this, of course, is that it would be the end of money as we know it. A world with six billion different currencies is, in effect, a world with no money at all. Under these conditions we would fall back to a situation of barter.

Mundell himself sees this problem.[18] But rather than shrinking in horror from either scenario (especially the latter) he proposes what all economists in good standing in the neoclassical school would propose - a cost benefit analysis. If the primary goal is economic stability, then the number of currencies should be larger; if it is the use of money as a medium of exchange, then the fewer the different numbers of currencies the better. So, what *is* the optimal number of currencies for the world? Mundell does not vouchsafe us a specific answer to this rather important question. Reading between the lines, one gets the feeling that this number should lie for Mundell somewhere in between several dozen to a few hundred, but as he never specifies, this is at best an educated guess.

So far, we have accepted the stability argument; the quaint Keynesian notion that monetary and fiscal policy can lead us to the promised land. Actually, however, the charge that Keynesianism is dead from the neck up is hard to resist. And that it was killed off by the spectre of inflationary recession. For in this world view, the antidote to inflation is to draw down expenditure, whether by fiscal or monetary policy. The cure for unemployment, on the other hand, is to increase general spending. What happens if there is *both* unemployment and inflation in the system? Stepping on the gas will solve the former problem, but aggravate the latter; hitting the brakes will have the opposite effect. The wonder of the matter is not that Keynesianism has foundered on this particular set of shoals, but that it continues to enjoy a ghoulish existence despite the foregoing. With the best will in the world, monetary and fiscal policy are just not up to the job. Rather than anti-cyclical, bureaucratic interference with the market has been *pro*-cyclical.[19] Nor can we rely on the best will in the world, as the Public Choice School (Buchanan, 1975; Buchanan and Tullock, 1971) has so valiantly taught us. For civil servants, not only private entrepreneurs, can be expected to indulge in "rent seeking"[20] at the expense of the public good.

A further problem with the Mundell model is that it is open to a possible reductio ad absurdum rejoinder. At present, no one worries about "balance of payments" problem between New York State and New Jersey. Nor between California and Maine, nor Oregon and Florida. But with the advent of the Mundellian perspective, this would no longer be true. Now, we can add this worry to all the rest which plague mankind.

4. **Fredrich Hayek**

Hayek (1976) opposes the gold standard. This, indeed, is puzzling, since he has several good things to say about this system:

> "...significantly, it was only during the rise of the prosperous modern industrial systems and *during the rule of the gold standard*, that over a period of about two hundred years...prices were at the end about where they had been at the beginning (emphasis added)" (1976, p.9).

> "With the exception only of the 200-year period of the gold standard, practically all governments of history have used their exclusive power to issue money in order to defraud and plunder the people." (1976, p.16)

Why this rejection? It would appear that this is out of a counsel of despair. It is not that he specifically opposes such a system, so much, as it is based on a fear that it would not be allowed to function due to the political realities:

> "I do not believe we can now remedy this position by *constructing* some new international monetary order, ... or even an international agreement to adopt a particular mechanism or system of policy, such as the classical gold standard. I am fairly convinced that any attempt now to reinstate the gold standard by international agreement would break down within a short time and merely discredit the ideal of an international gold standard for even longer." (1976, p.15)

Unfortunately, Hayek does not realize that the political impossibility of a gold standard - due in part to a rent seeking desire for inflationary policies - would tend to apply to any other scheme addressed to this end, and for the same reasons. To wit, if the politically powerful desire inflation, and are able to quell the gold standard on this ground, then they would likely be able to obviate any other system, such as the one now proposed by Hayek, which had the same effect.

Another problem is that Hayek does not appreciate the fact that if those such as himself who would advocate gold (but for its expected political impossibility) refrain from doing so on this ground, then they themselves render such an occurrence less likely.

Hayek (1976) repudiates gold for these reasons which, perhaps, may best be characterized as psychological. That is, he implies that there is something problematic about "discredit(ing) the ideal of an international gold standard," and that it would only break down due to lack of widespread appreciation for it.

But in his 1990 work he rejects gold on more sharp and forceful grounds: the government cannot be trusted to run the system, and it not worthy of being run in the first place. He states (1990, p.110):

"Most people therefore now believe that relief can come only from returning to a metallic (or other commodity) standard. But not only is a metallic money also exposed to the risks of fraud by government; even at its best it would never be as good a money as one issued by an agency whose whole business rested on its success in providing a money the public preferred to other kinds. Though gold is an anchor - and any anchor is better than a money left to the discretion of government - it is a very wobbly anchor. It certainly could not bear the strain if the majority of countries tried to run their own gold standard. There just is not enough gold about."

There are several problems with this analysis. First, while it is undoubtedly true that "a metallic money (is) also exposed to the risks of fraud by government,"[21] we should also recognize that metallic money is in far *less* danger of debasement than anything else - particularly Hayek's own suggestion of a market basket of fiat currencies. Debasement might have worked for the king several centuries ago, but what with the modern science of metallurgy, the treasury will likely be in a straight jacket as far as this scam is concerned.

Second, Hayek is wrong in implying that gold is *not* "issued by an agency whose whole business rested on its success in providing a money the public preferred to other kinds." Our Nobel Laureate presumably supposes that a gold standard must be administered by government. Nothing, however, could be further from the truth. While it can of course not be denied that historically the state has indeed achieved control over what passed for a gold standard, this is by no means necessary. That is, it is entirely possible, and plausible, for the whole industry - from mining to minting, from banking to warehousing, from certification to providing brand names - to be run privately. And this is precisely the public policy alternative to his "competing money" system.

Third, there is no minimal requirement with regard to the number of gold ounces available to serve as the money. There is thus no "strain" that "could not be borne," if not only the majority of countries, but the entire world, with Mars and Venus tossed in for good measure, decided to embrace the gold standard. All that would occur is that the value of each gold ounce would rise in value, until, in equilibrium, the monetary needs of the entire community could be satisfied.

Instead of the gold standard, Hayek proposes[22] the elimination of legal tender laws (1976, pp.17-19), coupled with competition between the present statist currencies, and a new one to be called the "ducat" (1990, p.46)

No one who favors freedom in the monetary area can disagree with Hayek's call to end legal tender laws. These are an affront to our rights to contract. If I purchase a cow from you, and promise to pay you two ounces of gold, under this enactment I may break our agreement, and force you to accept instead some fiat coins of the realm, which are legal tender for all debts public and private. Under strict legal tender laws, you have no right to insist that I honor our contract and pay you back in gold.[23]

But this step is only necessary for monetary liberty, not sufficient. And, as it happens, accomplishing it will do very little for the ultimate goal. Why is this? It is because this public policy recommendation fails to incorporate the insights of Mises' (1912) regression theorem.[24] In that view, money must originally have been a commodity, highly valued for reasons other than its ability to transact business. It was initially accepted as a money in return for goods other than its ability to transact business. It was initially accepted as a money

in return for goods or services only because of the well founded expectation that when the recipient wished to turn around and buy other items with the good he has just received, he would be able to do just that. Without this assurance, no one would accept the item in payment for parting with the good or service in question in the first place. And what explains this pattern of trust, or acceptability? The fact that the (soon to be money) commodity was in wide use on the basis of its own merits as a consumption item.[25]

States Rothbard (1981-1982, p.9):

> "...Hayek's plan ignores the most fundamental part of Mises' regression theorem: that nothing ever becomes money out of the blue; that it can only emerge as money as a unit of weight of a useful market-produced commodity; almost always either gold or silver. Once the public becomes accustomed to the dollar or pound as a unit of weight of gold, *then* the government can sever the accustomed name from its base in the market-produced commodity, and seize the monopoly of supplying it as a fiat currency - with results that we know all too well in the 20th century."

The key element of money ("moneyness") is this pattern of trust, or acceptability. Without it, nothing can be money, be it ever so attractive, and imbued with the figures of no matter how many princes or presidents. With it, practically *anything*[26] can be money, no matter how modest and unassuming. Once this faith or credence has been established, it is very hard to break it.[27]

Legal tender and other statist laws were undoubtedly instrumental in the past in breaking the link between the commodity gold and the "moneyness" it once had. But it does not follow that rescinding this law now will succeed in turning back the clock. On the contrary, once acceptability of a fiat currency has been attained in this way, legal tender laws are no longer necessary to maintain it. Money has a life of its own in this respect, barring extraordinary circumstances, such as hyperinflation.

The reason we all accept US currency today is *not* due to the legal tender law. It is because of its present "moneyness:" we all have the firm conviction that if we accept it, others will, too, when it comes time for us to spend it. If the legal tender law were rescinded tomorrow, US currency would likely still circulate as a money.

Let us now consider the second aspect of Hayek's proposal, competition between fiat currencies, up to and including the "ducat," a basket of other fiat currencies. There is, to be sure, nothing wrong with competition. If anything, there is far too little of this precious activity, and more can well be preferred to less. But what is needed is *market* competition, not competition between fiat currencies. For economic liberty consists of private individuals competing against one another; it has nothing to do with rivalry between states, or statist institutions such as fiat currency.

States Rothbard (1981-1982, p.9):

> "(Here is) the major flaw in Hayek's scheme: Not just that no one would pay any attention to these currencies, but that the scheme leaves the really important current moneys, dollars, pounds, etc., in the hands of monopoly government. Hayek's 'denationalized' money may allow for freedom to produce such trivial paper tickets as 'Hayeks' and 'Rothbards', ('Ducats') but it would disastrously leave real money: dollars, pounds, etc. safely nationalized and monopolized in the hands of govern-

> ment. And so inflation would proceed unchecked upon its way" (material in brackets supplied by present author).

It cannot be denied that the Catholic notion of subsidiarity, or decentralism, or federalism, has a role to play; but only within *political* institutions. That is to say, for any given level of governmental intervention, it is better that it take place at the local than at the central level. This is because people can always "vote with their feet" if a city or state becomes abusive, but find it far more difficult to move to a different country if victimized at that level.

For example, it would enhance liberty by not one whit should the government create a second wholly owned post office, to compete with the first. Customers may possibly receive better service, but that is an entirely different matter. The same applies to a school voucher program whose only effect is to promote competition within the public school system. Again, there might conceivably be a gain in efficiency from such an enterprise, but this can have nothing to do with free markets, since by definition such institutions are in no way involved.

Hayek's suggestion is subject to much the same criticism as were flexible exchange rates. The similarity is that in both cases trade and competition are supported. But these phenomena are only necessary, not sufficient, for a free market. Also required is an underlying set of legitimate property rights. One might as well advocate trade in stolen goods. This, too, would increase utility in the sense that this term is used in welfare economics. But it would not augment liberty. On the contrary, heightened efficiency would reduce it; for if there must be theft in this world, at least it should be allowed to be as *in*efficient as possible. The point is, fiat currencies are not themselves aspects of markets; they are not derived, nor deriveable, from voluntary choices of consenting economic actors. They are, rather, imposed from above by the political system. As such, trade in them, no matter how salutary on other grounds, cannot be counted as an aspect of economic freedom.

Hayek's competitive ducat system may in some practical ways be preferable to present institutional arrangements. It will not increase freedom, but it may enhance consumer satisfaction. But clearly it is inferior to gold on both counts. This metal was chosen, not imposed by fiat; it is therefore compatible with free enterprise. And the fact that gold passed the market test of competition - something that cannot be said on behalf of any of these other alternatives - suggests that it is preferable on merely pragmatic grounds as well.

5. **Alan Greenspan**

This economist presents the greatest challenge to our thesis: that the four scholars named in the title of this paper do not consistently maintain their adherence to free market principles, at least when it comes to gold. The reason for the difficulty is that Greenspan (1966) is, seemingly, an enthusiastic supporter of the gold standard. Based on direct citations, he is as good on gold as it is possible to be, at least from a strictly economic perspective. It is worth quoting him at great length on this point, to show just how keen is his appreciation of the gold standard, and of its connection between gold and liberty:

> "An almost hysterical antagonism toward the gold standard is one issue which unites statists of all persuasions. They seem to sense - perhaps more clearly and subtly than many consistent defenders of laissez-faire - that gold and economic freedom are inseparable, that the gold standard is an instrument of laissez-faire and that each implies and requires the other." (p.96)

> "When gold is accepted as the medium of exchange by most or all nations, an unhampered free international gold standard serves to foster a worldwide division of labor and the broadest international trade. Even though the units of exchange (the dollar, the pound, the franc, etc.) differ from country to country, when all are defined in terms of gold the economies of the different countries act as one - so long as there are no restraints on trade or on the movement of capital." (p.98)

> "But the opposition to the gold standard in any form - from a growing number of welfare state advocates - was prompted by a much subtler insight: the realization that the gold standard is incompatible with chronic deficit spending (the hallmark of the welfare state)." (p.100)

> "This is the shabby secret of the welfare statist's tirades against gold. Deficit spending is simply a scheme for the 'hidden' confiscation of wealth. Gold stands in the way of this insidious process. It stands as a protector of property rights. If one grasps this, one has no difficulty in understanding the statist's antagonism toward the gold standard." (p.101)

It might be possible to find a more ringing endorsement of the gold standard, and in particular a tighter linkage between it and economic freedom, but one would have to delve deep into the literature to find it. For our purposes, we may take his statements as quite definitive: the gold standard enhances economic wellbeing, is necessary for economic freedom, and is cordially hated and detested by people who oppose liberty and prosperity, and for those very reasons.

How, then, can we account for the fact that Greenspan has been Chairman of the Federal Reserve System for many years, and not only do we not yet have a gold standard, we have absolutely no movement in that direction?[28]

In this context Rothbard's (1987) analysis of this puzzling situation has the ring of truth to it. In his view, Greenspan *does* favor gold and laissez-faire capitalism, but only on a high philosophical level where he does not have to *do* anything about it; in contrast, he does not champion it as a practical matter, for then he would be called upon at least to show some evidence of his beliefs. States Rothbard (p.3):

> "Greenspan's real qualification is that he can be trusted never to rock the Establishment's boat. He has long positioned himself in the very middle of the economic spectrum. He is, like most other long-time Republican economists, a conservative Keynesian, which in these days is almost indistinguishable from the liberal Keynesians in the Democratic camp... Which means that he wants moderate deficits and tax increases, and will loudly worry about inflation as he pours on increases in the money supply.

> "There is one thing, however, that makes Greenspan unique, and that sets him off from (the) Establishment ... And that is that he is a follower of Ayn Rand, and therefore 'philosophically' believes in laissez-faire and even the gold standard. But as *The New York Times* and other important media hastened to assure us, Alan only believes in laissez-faire 'on the high philosophical level.' In *practice* in the policies he advocates, he is a centrist like everyone else because he is a 'pragmatist.'...

> "Thus, Greenspan is only in favor of the gold standard if all conditions are right: if the budget is balanced, trade is free, inflation is licked, everyone has the right philoso-

> phy, etc. In the same way, he might say he only favors free trade if all conditions are right: if the budget is balanced, unions are weak, we have a gold standard, the right philosophy, etc. In short, *never* are one's 'high philosophical principles' applied to one's actions. It becomes almost piquant for the Establishment to have this man in its camp."

Of course, there are other possible explanations of this phenomenon: Greenspan has changed his mind about the efficacy of gold (but then, why not share his new reasoning with the world?), he still advocates this monetary standard, but deems it so politically incorrect as to not be feasible even to attempt to implement it (but who better than the Chairman of the Fed to do this?), he has fallen under the sway of the inside the beltway types, he regards his early flirtation with gold as a youthful indiscretion. But all of this is speculation. Perhaps his autobiography will one day clarify this matter.

6. **Conclusion**

We have considered the views of four economists usually associated with the free enterprise system. We have found that despite this background, none of them have consistently applied that theory to the question of the money medium. That is, all have rejected the gold standard - on one level or another.

Before calling into question their positions, we must address ourselves to one additional issue: have *any* erstwhile champions of capitalism seen their way clear to applying these principles to money? If not, then the failure of these four is perhaps more understandable; perhaps there is something about gold which renders the usual capitalist principles somehow inapplicable.

Unfortunately for this thesis, there are indeed economists who have championed the market in other areas, and nonetheless carried through consistently with regard to monetary policy. They have supported it, and not as a theoretical curiosity, but rather as a living, breathing vital aspect of political economy.

Endnotes

1. I would like to thank Masudul A. Choudhury, and Lawrence M. Parks for helpful comments which enabled me to improve this paper. All remaining errors are of course my own responsibility.

2. For a defense of this position, see Friedman, 1962, 1980; Mises, 1966; Rothbard, 1962.

3. And sometimes to silver, for smaller denominations.

4. The most important distinction in all of political economy, one which, unfortunately, escapes the notice of many commentators in this field.

5. See Mises (1912) for the view that fiat currency *must* arise through coercion.

6. This is a phrase paradoxically popularized by Milton Friedman. Paradoxically, in that he refuses to apply it to the field of money.

7. We shall challenge this assumption, or stipulation, below.

8. The German hyperinflation of the 1920s was perhaps only the most egregious example. See Friedman and Schwartz, 1963; Mises, 1966; Rothbard, 1983; Hoppe, 1993.

9. Is our line of reasoning guilty of violating the fallacy of composition? An objection to the thesis adumbrated here might be posed as follows: "Yes, yes, you have shown that the gold standard has real benefits as an insurance policy against government monetary profligacy, which has unfortunately characterized the history of virtually all nations. However, that is a matter of macroeconomics. Society as a *whole* would be better off with a gold standard. But as far as each *individual* is concerned, he has no such reason to favor the 'barbarous relic.' On the contrary, the typical economic actor rationally prefers fiat paper to commodity gold."

The reply is very straightforward. If this charge were true, the market would never have originally migrated to a gold standard. Instead, we would have moved directly to fiat currency.

10. I owe this point to Roger Garrison.

11. True, as a medium of exchange will increase its value over and above what it would have been for purely metallic use (jewelry, dentistry, etc.). But this cannot be used to deny the proposition that vast amounts of the yellow metal will still be dug up and then reburied, whether or not it is used as money. This assumes not only that gold is not used as money, but also that it is not expected in the future to be used for this purpose. Further, it is highly probable that were gold's "moneyness" to be ended entirely, there would be at least a temporary end to the mining of this metal, as the some 135,000 tonnes now above ground could be used for other purposes. (I owe these latter two points to Lawrence M. Parks).

12. To be fair to him, it must be conceded that the use of substitutes is compatible with practically *any* monetary regime. But it cannot be denied that this also applies to gold.

13. True, this also has its political and economic costs, particularly for those who see a connection between the prestige of a country and the value of its currency in foreign exchange markets. These costs, however, are not sharp and painful; they do not constitute a "crisis."

14. His purpose here was to criticize flexible exchange rates, not the gold standard, but his analysis is nonetheless germane to our present concerns.

15. For a critique of the Keynesian system, see Hazlitt (1959).

16. Objections might be levelled at the claim that this is Keynesian and not "monetarist." Although most debates on this and related topics in the professional literature have been between these two purported schools of thought, nothing of the kind is true. But both monetarists and fiscalists employ the Keynesian model of aggregate demand. Therefore, these controversies are more of an internecine battle than a disagreement between two separate philosophies. As Friedman himself says, "we are all Keynesians now" (cited in Samuelson, 1970, p.193).

As it happens, Friedman objects that he has been quoted out of context (personal correspondence). His full statement on this matter as follows: "If by Keynesianism you mean public policy prescriptions of big government budgets, deficit spending, etc., then there are great differences between we monetarists and the Keynesians; but if you mean utilization of the same tools of economic analysis, then we are all Keynesians now" (paraphrase, based on personal conversation). For some purposes, one is inclined to take the Friedman side in his altercation with Samuelson. But for our public policy purposes, the alternative view has its attractions.

17. Mundell, 1961, p.662 sees this as a problem, but contents himself with an appeal to "commonsense." One problem with his analysis is that the decision as to how many "regions" there are, and hence how many currencies would be in existence, is not one to be made by the market. Rather, the unspoken implication is that it would be made by Mundell, or a band of economists, or politicians, or perhaps by the entire economics profession. It is likely that if the choice came down to a market or political decision, Mundell would opt for the latter.

18. States Mundell, 1961, p.660, "...the concept of optimum currency areas helps us to see that the conflict...between Meade, who sees the need for more currencies, and Scitovsky, who sees the need for fewer...reduces to an empirical rather than a theoretical question."

19. It was for this reason that Friedman penned his famous aphorism, "rules not authority in monetary policy" as part of his public policy suggestion that the fed be limited to increasing the money supply by 3% annually. See also Simons (1936).

20. See Krueger, 1974; Posner, 1975; Tullock, 1967, 1980.

21. It would seem that *nothing* is free of this particular risk.

22. See also Hayek (1948).

23. From time to time gold clauses become legal, as do futures contracts which allow for gold delivery. This complicates the situation somewhat. (I owe this point to Lawrence M. Parks).

24. For critiques of this theorem, see Patinkin (1965), Anderson (1936) and Ellis (1934); for replies, see Mises (1966, pp.405-419) and Rothbard (1991).

25. This is why early monies typically consisted of salt, or sugar, or dried fish or some such. For a discussion of this process see Menger (1950, pp.257-285).

26. Radford (1945) tells of cigarettes being used as money in prison of war camps.

27. Hyperinflations may sometimes be sufficient to wean an economy away from its money, but little else can.

28. To be fair to Greenspan, he has spoken publicly in favor of the gold standard. For example, see his speech at Catholic University, Leuven, Belgium, on January 14, 1997. (For a commentary on this see Parks, 1998). But efforts such as these are hardly consistent with serious public policy support for this system. Surely a strong advocate of a free market gold standard would make this a centerpiece of his administration; perhaps even go so far as to threaten to resign were it not implemented, let alone seriously studied with a view toward implementation.

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