1.00

Inflation, or Gold Standard?

by

Prof. Hans F. Sennholz

Published by
Bramble Minibooks

III - 73

Perils of Inflation

What Inflation Is

It is not money, as is sometimes said, but the depreciation of money — the cruel and crafty destruction of money — that is the root of many evils. It destroys individual thrift and self-reliance as it gradually erodes personal savings. It benefits debtors at the expense of creditors as it silently transfers wealth and income from the latter to the former. It generates the business cycles, the stop-and-go boom-and-bust movements of business that inflict incalculable harm on millions of people. For money is not only the medium for all economic exchanges, but as such also the lifeblood of the economy. When money suffers depreciations and devaluations it invites government price and wage controls, compulsory distribution through official allocation and rationing, restrictive quotas on imports, rising tariffs and surcharges, prohibition of foreign travel and investment, and many other government restrictions on individual activities. Monetary destruction breeds not only poverty and chaos, but also government tyranny. Few policies are more calculated to destroy the existing basis of

a free society than the debauching of its currency. And few tools, if any, are more important to the champion of freedom than a sound monetary system.

Inflation is the creation of new money by monetary authorities. In more traditional terminology, it is the creation of money that visibly raises goods prices and lowers the purchasing power of money. It may be creeping, trotting or galloping, depending on the rate of money creation by the authorities. It may take the form of "simple inflation," in which case the proceeds of the new money issues accrue to the government for deficit spending. Or it may appear as "credit expansion," in which case the authorities channel the newly created money into the loan market. The government may balance its budget, but in order to stimulate business and promote full employment it may inject new credits into the banking system. Both forms are inflation in the broader sense and as such are willful and deliberate policies conducted by government.

Ours is the age of inflation.[1] All national currencies have suffered serious depreciations in our lifetime. The British pound sterling, the shining ex-

(1) Cf. Jacques Rueff, THE AGE OF INFLATION, Chicago, Ill.: Henry Regnery Company, Gateway Editions, 1964.

ample of hard money for one hundred years, has lost almost 90 per cent of its purchasing power and suffered four devaluations since 1931. The powerful U.S. dollar of yesteryear has lost at least two-thirds of its purchasing power and continues to shrink at accelerating rates. In the world of national currencies there have been nearly 400 full or partial devaluations since World War II. Many currencies have suffered total destruction and their replacements are eroding again.

Ideas Shape Policies

To inquire into the causes that induce governments the world over to embark upon such monetary policies is to search for the monetary theories and doctrines that guide their policy makers. Ideas control the world, and monetary ideas shape monetary policies. Several distinct economic and monetary doctrines have combined their forces to make our age one of inflation. One doctrine in particular enjoys nearly universal acceptance: the doctrine that government needs to control the money.

Even many of the champions of private property and individual freedom stop short at money. They are convinced that money cannot be left to the vagaries of the market order, but must be controlled by government. Money must be supplied and re-

gulated by government or its central bank. *That money should be free is inconceivable to typical twentieth-century man.* He depends on government to mint his coins, issue his notes, define "legal tender," establish central banks, conduct monetary policy, and then stabilize the price level. In short, he wholly relies on government regulation of money. But this trust in monopolistic monetary authority operating through political processes inevitably gives rise to monetary destruction. In fact, money is inflated, depreciated, and ultimately destroyed whenever government holds monopolistic power over it.

Government Control of Money

Throughout the history of civilization, governments have been the chief cause of monetary depreciation. It is true, variations in the supply of metallic money, due to new gold and silver discoveries, occasionally affected the value of money. But these changes were rather moderate when compared with those caused by government coin debasements or note inflations. Especially since the rise of statism and the "redistributive society," governments all over the world have embarked upon unprecedented inflations the disastrous effects of which can only be surmised. To entrust our

money to government is like leaving our canary in trust with a hungry cat.

From the Roman caesars and the Medieval princes to contemporary presidents and prime ministers, their governments have this in common: the urgent need for more revenue. The large number of spending programs such as war or preparation for war, care of veterans and civil servants, health, education, welfare, urban renewal, and the like, places a heavy burden on the public treasury, which is finally tempted to provide the necessary funds through currency expansion. True, government at first may merely endeavor to tax wealth and income — tax Peter to pay Paul. But this convenient and popular source of government support is practically exhausted when Peter's income tax reaches one hundred per cent. At this point, for additional revenue, the government must either raise everyone's taxes or turn to currency expansion. But the former is rather unpopular and therefore inexpedient politically. To win elections, the taxes may even be lowered and the inevitable deficits covered through currency creation, i.e., inflation.

The Steps Toward Monopoly

The first step toward full development of this

source of revenue was the creation of a government monopoly of the mint. To secure possession of the precious metals that circulated as coins, the sovereign prohibited all private issues and established his own monopoly. Minting became a special prerogative of the sovereign power. Coins either carried the sovereign's picture or were stamped with his favorite emblems. But above all, his mint could now charge any price for the coins it manufactured. Or it could reduce the precious metal content of the coins and thus obtain princely revenues through coin debasement. Once this prerogative of sovereignty was safely established, the right to clip, degrade, or debase the coinage was no longer questioned. It became a "crown right" that was one of the chief sources of revenue.[2]

An essential step toward gradual debasement of the coinage was the separation of the name of the monetary unit from its weight. While the original names of the coins designated a certain weight and thus afforded a ready conception of their gold or silver content — pound, libra or livre, shilling, mark, and so on — the new names were void of any reference to weight. The pound sterling was no longer a pound of fine silver, but anything the

---

(2) Cf. Groseclose, Elgin. MONEY AND MAN, New York, N.Y.: Frederick Unger Publishing Co., 1961, p. 55 et seq.

sovereign might designate as the national monetary unit. This change in terminology widely opened the door to coin debasement.

The next step toward full government control over money was the passage of legal tender laws, which dictates to people what their legal money can be. Such laws are obviously meaningless and superfluous wherever the ordinary law of contract is respected. But where government wants to issue inferior coins or depreciated paper notes, it must use coercion in the form of legal tender legislation. Then it can circulate worn or debased coins side-by-side with the original coins, falsify the exchange ratios between gold and silver coins, and discharge its debt with the over-valued coins, or make payments in greatly depreciated fiat money. In fact once legal tender laws were safely established, deb repudiation through monetary depreciation coul become one of the great injustices of our time Contemporary jurisprudence and jurisdiction wer utterly paralyzed in their defense and administratio of justice once they accepted legal tender laws A debt of a million gold marks thus could be legall discharged with one million paper marks tha bought less than one U.S. penny. And a goverr ment debt of fifty billion 1940 dollars can now b paid or refunded with a 1973 dollar issue that

vorth less than one-third of the original amount. Vith the blessings of the courts, millions of credi-ors can now be swindled out of their rightful laims and their property legally confiscated.[3]

But absolute government control over money vas only established when money substitutes in the orm of paper notes and demand deposits came nto prominence. As long as governments had to nake payments in commodity money, inflationary olicies were limited to the primitive methods of oin debasement. With the advent of paper money nd demand deposits, however, the power of govern-nent was greatly strengthened, and the scope of nflation vastly extended. At first, people were nade familiar with paper money as mere substi-utes for money proper, which was gold or silver. Government then proceeded to withdraw the pre-ious coins from individual cash holdings and con-entrate them in its treasury or central bank, thus eplacing the classical gold-coin standard with a old bullion standard. And finally, when the people ad grown accustomed to paper issues, government ould deny all claims for redemption and estab-sh its own fiat standard. All checks on inflation ad finally been removed.

---

(3) von Mises, Ludwig. HUMAN ACTION, New Hav-en, Conn.: Yale University Press, 1949, pp. 432, 444.

The Role of the Central Bank

The executive arm of government that conducts the inflation usually is the central bank. It does not matter who legally owns this bank, whether private investors or the government itself. Legal ownership always becomes empty and meaningless when government assumes total control. The Federal Reserves System which is legally owned by the member banks is the monetary arm of the U.S. government and its engine of inflation. It enjoys a monopoly of the note issue which alone is endowed with legal tender characteristics. Commercial banks are forced to hold their reserves as deposits with the central bank, which becomes the "banker's bank" with all the reserves of the country. The central bank then conducts its own inflation by expanding its notes and deposits while maintaining a declining reserve ratio of gold to its own liabilities, and directs the bank credit expansion by regulating the legal reserve requirements the commercial banks must maintain with the central bank. Endowed with such powers, the central bank now can finance any government deficit, either through a direct purchase of treasury obligations or through open-market purchase of such obligations, which creates the needed reserves for commercial banks to buy the new treasury issues.

The final step toward absolute government control over money, and its ultimate destruction, is the suspension of international gold payments, which is the step President Nixon took on August 15, 1971. When a central bank is hopelessly overextended at home and abroad, its currency may be devalued, which is a partial default in its international obligations to make payment in gold; or in an outburst of abuse against foreigners and speculators, the government may cease to honor any payment obligations, as in the case of the U.S. default. All over the world, government paper now forms 120 national fiat standards that are managed and depreciated at will.

The decline of monetary freedom and the concomitant rise of government power over money gave birth to our age of inflation. Step by step, government assumed control over money, not only as an important source of revenue but also as a vital command post over our economy. The result is continuing inflation. Only monetary freedom can impart stability.[4]

---

(4) Cf. von Mises, Ludwig. THE THEORY OF MONEY AND CREDIT, Irvington, N.Y.: FEE, 1971, pp. 413 et seq.; Rothbard, Murray N. MAN, ECONOMY AND STATE Princeton, N.J.: D. Van Nostrand Co., 1962, p. 661 et seq.; also his concise WHAT HAS GOVERNMENT DONE TO OUR MONEY? Pine Tree Press, 1963.

Welfarism and Inflation

Even the noblest politicians and civil servants can no longer be expected to resist the public clamor for social benefits and welfare. The political pressure that is brought to bear on democratic governments is rooted in the popular ideology of government welfare and economic redistribution. It inevitably leads to a large number of spending programs that place heavy burdens on the public treasury. By popular demand, weak administrations seeking to prolong their power embark upon massive spending and inflating in order to build a "new society" or provide a "better deal." The people are convinced that government spending can give them full employment, prosperity, and economic growth. When the results fall far short of expectations, new programs are demanded and more government spending is initiated. When social and economic conditions grow even worse, the disappointments breed more radicalism, cynicism, nihilism, and aobve all, bitter social and economic conflict. And all along, the enormous increase of taxes, chronic budget deficits and rampant inflation.[5]

---

(5) Hazlitt, Henry. MAN VS. THE WELFARE STATE, New Rochelle, N.Y.: Arlington House, 1969, p. 57 et seq.

The "redistributive" aspirations of the voting public often induce their political representatives in Congress to authorize and appropriate even more money than the President requests. Such programs as social security, medicare, anti-poverty, housing, economic development, aid to education, environmental improvement, and pay increases for civil servants are so popular that few politicians dare to oppose them.

The government influences personal incomes by virtually every budget decision that is made. Certainly its grants, subsidies, and contributions to private individuals and organizations aim to improve the material incomes of the beneficiaries. The loans and advances to private individuals and organizations have the same objective. Our foreign aid program is redistributive in character as it reduces American incomes in order to improve the material condition of foreign recipients. The agricultural programs, veteran's benefits, health, labor and welfare expenditures, housing and community development, Federal expenditures on education, and last, but not least, the social insurance and medicare programs directly affect the incomes of both beneficiaries and taxpayers. As the benefits generally are not based on tax payment, but rather on considerations of social welfare, these programs constitute redistribution on a nationwide scale.

Foreign aid programs have extended the principle of redistribution to many parts of the world.

Whenever government expenditures exceed tax collections and the government deficit is covered by currency and credit expansion, we suffer inflation and its effects. The monetary unit is bound to depreciate and goods prices must rise. Large increases in the quantity of money also induce people to reduce their savings and cashholdings which, in the terminology of mathematical economists, increases money "velocity" and reduces money value even further. It is futile to call these people "irresponsible" as long as the government continues to increase the money stock.

Labor Union Pressures

A very potent result of inflation is the unrelenting wage pressure exerted by labor unions. It is true, labor unions do not directly enhance the quantity of money and credit and thus cause the depreciation. But their policy of raising production costs inevitably causes stagnation and unemployment. This is why the union strongholds are the centers of unemployment. Faced with serious stagnation, the labor leaders are likely to become spokesmen for all schemes of easy money and credit that promise to alleviate the unemployment plight. The democratic government in turn does not dare to

oppose the unions for political reasons. On the contrary, it does everything in its power to reduce the pressure which mass unemployment exerts on the union wage rates. It grants even larger unemployment benefits and embarks upon public works in the depressed unionized areas. At the same time it expands credit, which tends to reduce real wages and to encourage employment.

The demand for labor is determined by labor costs. Rising costs reduce the demand, falling costs raise it. Inasmuch as inflation reduces the real costs of labor, it actually creates employment. When goods prices rise while wages stay the same, or prices rise faster than wages, labor becomes more profitable to employers. Many workers, whose employment costs heretofore had exceeded the value of their productivity so that they were unemployable, now can be profitably re-employed. Of course, this employment-creating policy is then counteracted by such unemployment factors as rising minimum wage rates. higher unemployment benefits and welfare doles, and rising union wage scales and fringe-benefit costs. In many industries, the labor unions have introduced "cost-of-living clauses" that aim to prevent the decline of real wages through monetary depreciation. Or their wage demands take into consideration the rising rates of monetary depreciation. Their demands

may become "exorbitant," their strikes longer and uglier, and the economic losses inflicted on business and the public ever more damaging until businessmen clamor for government wage controls. With wage controls come price controls and the whole paraphernalia of the command system.

The "New Economics"

To give "scientific" justification to the policy of inflation, a host of contemporary economists have developed intricate theories, commonly known as the "new economics." Basically, they all ascribe to government the magic power of creating real wealth out of nothing, of raising the "national income" through minute efforts of the central bank and its printing presses. They are unanimous in their condemnation of the gold standard, which to them means dominations by "external forces" and denial of national independence in economic policies. Of course, the "independence" they so jealously uphold is tantamount to government control over money matters. They want "fiat money," i.e. government money without restraint by a commodity such as gold. Though some would allow us the freedom to buy and hold gold coins or bullion, they know very well that the legal tender laws that support the fiat standard deny us the

right to use gold in economic exchanges, which relegates all coins to hoards and coin collections.

Government Control Means Inflation

The economic problem of government differs radically from that of its subjects. Individuals produce goods and services in order to earn their livelihood. Government expropriates individual income and wealth in order to cover its expenses. While individuals must produce more in order to earn more, governments must find new methods of expropriation. The tax levies must be raised, or new taxes imposed. But taxation is often unpopular, and may precipitate the downfall of governments. This is why inflation is such a convenient source of revenue.

Although inflation is a vicious form of taxation it may even be popular because its effects are rarely understood. There are the beneficiaries of inflation who sing loud praises of "easy money" and "credit expansion." The government and its economists even invent complex theories and doctrines in support of inflationary policies. For inflation boosts government revenue and permits politicians to spend more money than they can raise by taxes. Inflation also repudiates government debt as it reduces its purchasing power. In this respect it is a silent tax on all creditors and money holders.

Readers interested in gold and silver mining stock are invited to order a forthcoming MiniBook by Jack Weber and Harry Browne in which they examine in detail the best of the world's mining equities — and make their recommendation for prudent investors. Cost is $1.00.
(Should be ready for distribution about May 20, 1973)

It is rarely understood that inflation generates a vast redistribution process. It shifts wealth and income from the pockets of creditors to those of debtors. It reduces the standards of living of people with fixed incomes, in particular, the aged and handicapped. And it diminishes the value of savings bonds and savings accounts, mortgages and life insurance policies, pensions and other savings. It causes the economic instabilities of the trade cycle. And, above all, the losses which inflation inflicts on millions of people breed a political and economic radicalism that tends to destroy our private property order.

In March 1933, the Roosevelt Administration expropriated the monetary gold owned by the American people and thus forcibly opened the gates for unrestricted money management. We entered a new era of government spending and inflating. A few figures may illustrate the point.

THE FEDERAL BUDGET AND DEBT
(in millions of dollars)

	Receipts	Expenditures	Surplus or Deficit	Public Debt at end of year
1933	1,997	4,598	— 2,602	22,539
1943	25,097	78,909	— 53,812	140,796
1953	71,495	76,769	— 5,274	266,123
1963	106,560	111,311	— 4,751	310,800
1973 estimated	224,984	249,796	— 24,812	473,300
1983 projected	700,000	825,000	— 125,000	1,400,000
1993 projected	3,000,000	4,000,000	—1,000,000	4,000,000
2003 projected	300,000	300,000	0	1,000,000
in new currency				

Source of 1933-1973 data: THE BUDGET OF THE UNITED STATES GOVERNMENT, 1974, pp. 370, 371. Projections by this writer.

THE INFLATION
(in billions of dollars)

	Currency	Demand Dep.	Time Dep.	Total
March 1933	5.5	13.5	21.8	40.8
March 1943	14.9	54.2	29.2	98.3
March 1953	27.6	99.8	66.5	193.9
March 1963	30.4	117.3	145.1	292.8
March 1973 estimated	68.0	207.0	415.0	690.0
March 1983 projected	204.0	621.0	830.0	1,650.0
March 1993 projected	408.0	1,242.0	2,500.0	4,100.0
March 2003 projected	100.0	200.0	300.0	600.0
in new currency				

Source of data: FEDERAL RESERVE BULLETINS. Projections by this writer.

The quantity of money has grown phenomenally and its value deteriorated drastically. Consumer prices nearly tripled according to government's own indices. It is true, prices cannot be recorded correctly, nor can government be expected to report them objectively without political considerations. Especially price indices can be easily molded and tailored for political ends. Nevertheless, even government statistics may be useful in demonstrating a trend.

CONSUMER PRICES AND CONSUMER PURCHASING POWER OF THE DOLLAR (1933 equals 100)

1933		100	100c
1943		134	74c
1953		207	48c
1963		237	42c
1973	estimated	349	28c
1983	projected	1,000	10c
1993	projected	10,000	1c
2003	projected in new currency	400	25c

Data computed from Bureau of Labor Statistics. Projections by this writer.

Redistribution of Income and Wealth

Inflation causes displacements in the distribution of income and property. As lenders and borrowers,

most people usually do not take into account variations in the objective exchange value of money. If the monetary value should decline, the lenders are bound to suffer losses in purchasing power while the borrowers gain a corresponding amount. There are long-term contracts that do not have to be fulfilled until a later point in time. There are long-term employment contracts or contracts for the supply of materials, all of which involve money payments over time, that entail inflationary risks.

It is a popular, although erroneous, belief that inflation affects only wealthy individuals because they are said to be the money lenders. This may have been true during the Middle Ages when economic wealth was concentrated with a few wealthy noblemen and merchants, while the masses of people were struggling for mere survival. But ever since the nations of the West emerged from feudalism and mercantilism, and tried individual freedom and enterprise, an ever-growing number of people were able to save some part of their rising incomes, so that probably most people today are lenders on net balance. They are the millions of creditors of life insurance companies, pension funds, savings banks, and similar institutions. Millions own government savings bonds and other money assets. It is true, they may have charge accounts and other consumer debt. But in most cases savings probably exceed

obligations. This single fact already indicates that the people, at large, are vitally interested in sound money.

While most individuals mainly save in the form of money or claims to money, and thus are liable to be victimized by inflation, wealthy industrialists and capitalists usually are debtors on net balance. They may be indebted to bondholders, banks, and other financial institutions. They probably recognize the disastrous nature of inflation and, therefore, are hedging against it by avoiding investments in money or claims to money.

The disastrous nature of inflation becomes clearly apparent when we contemplate the magnitude of the losses inflation is inflicting on millions of American creditors every year. Even at the modest rate of five percent annual depreciation, the annual losses to creditors and gains to debtors amount to more than $100 billion a year.[6] The impact of this silent transfer of savings and wealth on millions of individual lives surpasses all imagination.

---

(6) Without allowance for duplications and deletions the following figures of outstanding debt at the end of 1972 are merely to indicate the magnitude of the transfer process: Federal government $450 billion, state and local government $152 billion, current liabilities of corporations $410 billion, mortgage debt $564 billion, consumer debt $158 billion, total bank deposits $515 billion. (FEDERAL RESERVE BULLETIN, Feb. 1973.)

Considering such staggering losses on the part of the thrifty and provident, the rising clamor for Welfare State measures is not surprising. These losses strengthened the demand for social security, aged health care, and governmental controls over prices and rents. They foster federal aid and subsidies and otherwise provide the chief arguments for an extension of government power.

Long-term employment contracts tend to inflict inflationary losses on millions of skilled and professional people. Within a few years of employment they may lose some ten percent or more of their income through monetary depreciation. Their relative economic and social position in society declines with the consequent decline of real income and wealth. This effect is all the more significant as it hurts especially that class of people that is most influential ideologically. There cannot be any doubt that the teachers, ministers, priests, and rabbis shape and significantly direct the moral, political and economic trends of the future. As fixed income receivers, they are especially victimized by inflation. This fact, in addition to their losses on savings, partially explains why most intellectuals are known to be more radical in political and economic outlook than many other groups of society.

Monetary depreciation inflicts special losses on yet another economic sector. All politically con-

trolled industries are especially vulnerable to inflation because their prices are not permitted to adjust to the monetary depreciation. Being subject to government control, their prices are fixed by "authoritative" decree in accordance with "authoritative" judgments of fairness and adequacy. American railroads and public utilities are eminent examples. Throughout the last thirty-five years of planned inflation they faced continously rising production costs. But their own charges and prices were determined by government committees and commissions. Without fail, price rises were authorized only after lengthy public hearings long after inflation had raised the production costs. In addition, the public authorities are tempted to "fight" inflation through resisting price increases by industries under their control. Thus squeezed by rising costs and relatively rigid prices, the financial position of these unfortunate industries deteriorated considerably. Today their economic plight has become a national dilemma.

Booms and Busts

The worst economic effect of monetary depreciation is the trade cycle with its boom and bust. What has been more demaging to individual freedom and the enterprise system than the recurrence of recessions and depressions? It was during the Great

Depression when interventionism and socialism made their greatest strides. And today, each new recession gives new impetus to the forces of statism.

Inflation at first produces conditions that appear favorable to everyone concerned. Businessmen make profits which, in fact, are generally larger than usual. There are few, if any, business failures. Employment and wages increase rapidly for which, of course, the labor unions and the Administration in power claim credit. The general atmosphere is one of confidence and prosperity. But then the inflation-induced activity tends to raise factor prices. The costs of labor, capital, and materials increase. In fact, they soar until profit margins return to normal and, finally, turn into losses. Another recession commences.

Recessions and unemployment are caused by maladjustments between prices and costs, not by mysterious lacks in consumption spending. Currency expansion causes price and income upheavals. It wastes resources by causing malinvestments and boom consumption. True, it may temporarily lead to utilization of labor and other resources hitherto priced out of the market. But it does not correct or alleviate maladjustments. It causes them.

Monetary expansion must solely be blamed for the numerous trade cycles that have plagued this country from its beginning. Whether it was the debauchery of the Continental currency by Con-

gress, or by expansionary adventures of the First and then the Second United States Banks, the inflations of the U.S. Treasury during the British-American War and the Civil War, the greenback and silver inflations, the World War I inflation, all these adventures in currency expansion constituted the causal preludes for the ensuing depressions. Likewise, the Great Depression had its beginning in the burst of credit expansion by the Federal Reserve System in 1924-1925 and again in 1927-1928. Without these inflationary adventures the stock market boom of 1928-1929 could not have developed and the ill-fated crash would not have occurred.[7] Since the end of World War II, the five recessions were preceded by five booms that were kindled by Federal Reserve credit expansion.

Full employment through currency expansion has become the official doctrine that guides the economic policies of most Administrations. Whether it is deficit financing or easy bank credit, the remoter consequences are always the same. The economic boom that is created is short-lived and inevitably ends in another slump. If, however, the monetary authorities should some day decide to keep the boom alive through continuously feeding it with ever-larger quantities of new money and credit, they

---

(7) Anderson, Benjamin. ECONOMICS AND THE PUBLIC WELFARE, D. Van Nostrand, 1949, p. 113 et seq.

would initiate the "crack-up boom" with its panicky flight into gold and other real value. This flight would signal the collapse of the currency. Or, the Administration that created the boom may finally want to "fight" it through all-round controls on prices, wages, and rents. In other words, the runaway inflation may lead us quickly into socialism.

Contrary to the wishful thinking of the expansionists, inflation sooner or later must come to an end. Once the people begin to realize that inflation is no Act of God, but the willful policy of the monetary authority, they may react by reducing their cash holdings, savings, and claims to money, and increase their purchases of goods and services. This reaction, which in terms of the mathematical economists is called an "increase in the velocity of money," would accelerate the rise of goods prices and the depreciation of the currency. Of course, the very authorities that inflated the currency will then blame the people for the depreciation and urge them to "hold the line on prices and wages." They may urge the citizenry to buy more savings bonds or even raise income taxes in order to reduce the people's spending power. Of course, all these measures must be futile because they aim at symptoms rather than causes. They enhance the spending power of the government and concomitantly reduce the freedom of the people. *Government*

alone is stictly accountable for inflation because government alone determines the money supply.

The people's freedom is greatly reduced by yet another concomitant effect of monetary depreciation. When our money incomes rise on account of inflation we are lifted into progressively higher income brackets. Inflation together with the feature of tax progression allows the government to absorb an ever-larger share of the people's earnings. In short, inflation pushes us all towards the top rate of income taxation, the seventy percent tax bracket.

Business income and taxation are especially affected by monetary depreciation. When prices rise, a distortion in profits takes place. They are made to appear far larger than they actually are. Inflation drives the cost of replacing plant and equipment far above the original cost. But for tax purposes the government recognizes only the original costs and thus forces business to overstate its actual earnings. It levies income taxes on imaginary profits that, in reality, are inflationary costs of replacement.

Inflation is Destroying the World Monetary System

The most spectacular effect of monetary depreciation is the gold and foreign exchange dilemma. When inflation raises the prices of goods and

services, gold becomes the cheapest export commodity. Gold, like any other commodity, tends to move from places of low value to places where it is valued more highly. It tends to leave countries where its purchasing power is declining and flows to countries where its value is higher. A government that depreciates its currency, and thus makes goods prices rise, drives gold out of its country. In fact, gold is so sensitive to monetary policies that a mere anticipation of inflation and credit expansion induces it to move.

Our easy-money predilection since World War II has reduced U.S. gold reserves until, on August 15, 1971, President Nixon was forced to suspend gold payments. In December 1971 the U.S. dollar was devalued by 8 percent and in February 1973 by another 10 percent. And when the dollar continued to decline after the two devaluations our creditor countries "floated" their currencies in order to insulate them from further imported inflation. The fall of the U.S. dollar not only inflicted huge losses on foreign central banks and depositors, who are holding more than $70 billion in U.S. currency or dollar claims, but also shattered the leading position of the U. S. dollar in international trade and finance. It inflicted a painful blow to American prestige in the world and to the American position of Free World leadership.

American gold losses were caused by the imbalance in the rates of monetary depreciation between the U.S. and its important trade partners in the rest of the world. Between the two world wars this imbalance worked in favor of the U.S., and European gold came to the United States in large quantities. When, after World War II, the European countries finally began to put their monetary houses in order, i.e. when most governments refrained from further deficit financing and the central banks from excessive credit expansion, the balances of payments began to change. Of course, the European monetary stabilization was accompanied or even preceded by drastic economic reforms that substituted free markets for government planning and control. Exchange controls were relaxed or abolished and foreign trade barriers lowered. But at the same time, the United States Government continued its policies of deficit financing and contracyclical credit expansion. And while the European governments tended to reduce the tax burdens on business and relaxed or abolished some bureaucratic controls, the business climate in the United States deteriorated steadily. During the 1950's and 1960's federal and state business taxes were kept at the peak reached during the Korean War. Social security and other wage taxes were raised. Depreciation allowances were greatly reduced and bureaucratic

controls intensified. The labor unions, strengthened by several National Labor Board and Supreme Court decisions, continued their militant drives towards higher production costs. And last but not least, five times within the short period of 25 years the American economy sank into the lethargy of recession. Laboring under radical government intervention and suffering greatly from its effects, the American economy literally depended for continuing operation on the frequent bursts of credit expansion emanating from the Federal Reserve System.

Having piled deficit upon deficit, and still continuing to announce huge spending programs, the danger of a collapse of the world monetary system has become real and imminent. This is not to imply that the situation is beyond the stage of possible repair. After World War II, most European countries succeeded in emerging successfully from similar situations. But such a repair would require a complete reversal of present-day economic and monetary policies of the United States Government. It would not suffice merely to stabilize the currency through balanced budgets and credit restrictions. For such a solution would immediately throw the American economy, which has more than four million unemployed even during boom times, into severe depression and unemployment. No political party would dare to recommend, not to mention adminis-

ter, this medicine for balance-of-payments corrections. Therefore, the currency reform necessitates a simultaneous economic reform that reduces the unbearable burden of government intervention. The business taxes, which are now the highest in the Free World, would have to be lowered considerably, and the markets be freed from bureaucratic intervention. At the same time, the numerous legal immunities and privileges of the labor unions would have to be abolished in order to restore a flexible labor market. Only a free labor market can absorb the labor that undoubtedly would be set free by the currency stabilization. Whether an Administration that is capable of such a radical reversal of present-day policies can soon be found is a political question, the answer to which must be sought in the realm of political understanding.

Without this radical reform, which is tantamount to a full retreat from the New Deal, Fair Deal, New Frontier, Great Society, and New Republicanism, further deterioration of the world monetary system is inevitable. And with this monetary deterioration must come a decline of world trade and commerce, of peaceful cooperation and division of labor. In fact, the disastrous consequences of our monetary policies can only be surmised. We may finally experience what many other nations have encountered during this century: a rapid depreciation of

the currency with all its calamities described above. Whether, under the intense economic, social, and political strains of such a currency disorder, we have the moral strength and economic wisdom to return to the ways of freedom, that is the question. When the U.S. dollar sinks to its knees under the weight of forty years of dealing and wheeling, spending and taxing, government welfare and omnipotence, will we crawl on to socialism and tyranny? Or, will we yet have enough moral and intellectual strength to rise from the morass of the redistributive society and once more walk the road of decency and freedom?

Return to freedom means return to the gold standard, which removes government from money and thus makes money free and sound.

THE GOLD STANDARD

As Old as Civilization

At the Democratic Party Convention, in July 1896, William Jennings Bryan made a famous speech on the gold standard. "You shall not press down upon the brow of labor this crown of thorns."

he orated. "You shall not crucify mankind upon a cross of gold."[8]

Is the gold standard really such a cross? Or is it a crown of public honesty and monetary stability?

Actually, *the gold standard is a monetary system in which gold is proper money and all paper moneys are merely substitutes that are payable in gold.* Under the gold standard the U.S. dollar is a piece of gold of a certain weight and fineness.

The gold standard is as old as man's civilization. Throughout the ages it emerged again and again because man needed a dependable medium of exchange. And gold provided such a medium. It was the most marketable good that gradually gained universal employment — and thus became money. Its natural qualities, i.e. its use for the manufacture of ornaments and jewelry, its easy divisability, great durability, storability and transportability, made this precious metal well suited also to serve as money.

Where gold coins were the accepted media of exchange, circulating by weight rather than name, money substitutes were also payable in gold. Paper notes and clay tablets promising to pay cash on demand were known already to the ancient world. The

---

(8) SPEECHES OF WILLIAM JENNINGS BRYAN, Revised and Arranged by Himself, N.Y., Funk & Wagnalls Co., 1909, Vol. I, p. 249.

ancient Chinese used gold coins some 3,000 years ago. The merchants of ancient Greece made payments in gold and silver coins more than 2500 years ago. In fact, the Greek city states struck gold coins that were masterpieces of beauty. The coins of Philip II of Macedon and his son, Alexander the Great, were freely accepted throughout the Greek world. They even reached Rome where they became the chief gold currency of the Republic.[9]

During the Middle Ages when economic relations disintegrated and great poverty spread over the Western world the silver standard generally replaced the gold standard. In Great Britain silver coins formed the basis of the monetary system until the middle of the eighteenth century. The U. S. had a de facto silver standard until the 1830's.

Freedom Gives Birth to Gold Standard

When trade and production expanded during the eighteenth and nineteenth centuries, the gold standard re-emerged. English merchants and goldsmiths

---

(9) Cf. Einzig, Paul, PRIMITIVE MONEY, London, Eyre & Spottiswoods, 1948, p. 228 et seq.: Quiggen, A. Hingston, A SURVEY OF PRIMITIVE MONEY, London, Methuen and Co., Ltd., 1949 pp. 271, 272; Burns, Arthur R., MONEY AND MONETARY POLICY IN EARLY TIMES, London, Routlege & Kegan Paul Ltd., 1927, pp. 1-36.

found gold coins very useful and therefore began to mint them. It is significant that the government did not establish the standard by any conscious and deliberate act. In fact, *the gold standard needs neither rules nor regulations, no legislation or government control, merely the individual freedom to own gold.* Of course, this freedom of gold ownership embodies the freedom not only to buy and sell gold for use in industrial production, but also to employ it in exchange.[10]

Restoration of monetary freedom means return to the gold standard and private coinage. From colonial times down to the middle of the nineteenth century Americans used gold coins struck by private mints. The Chalmers shilling, which was issued by a goldsmith of Annapolis in 1783, was freely used by the Founding Fathers. The ten-dollar pieces coined in 1830 and later by the mint of Templeton Reid of Georgia, containing gold to the value of $10.06, widely circulated throughout the South. Another mint in Rutherfordton, North Carolina, issued some $2.2 million of gold coins. In fact, an 1851 U.S. Mint report speaks of twenty-seven

---

(10) Menger, Carl, GRUNDSATZE DER VOLKSWIRTSCHAFTSLEHRE, Vienna, 1871, p. 250 et seq. English ed., PRINCIPLES OF ECONOMICS, The Free Press, Glencoe, Illinois, 1950, p. 257 et seq. von Mises, Ludwig, THEORY OF MONEY AND CREDIT, 3rd ed., New Haven: Yale University Press 1951, pp. 97-123.

different kinds of gold coins issued by fifteen private mints. This number even increased thereafter when numerous private mints in California issued fine gold coins bearing the names of the manufacturer.[11] Business transactions were conducted in gold, and money substitutes, such as bank notes and deposits, were payable in gold. If the people are free to choose between paper money and gold currency they naturally turn to gold. And this choice then forces all issuers of paper money also to make payments in gold lest their paper falls in utter disrepute and ceases to function as money.

Failure of the Bimetallic Standard

It is significant, however, that it was not monetary freedom that gave birth to the nineteenth century gold standards of the Western nations. There was no laissez-faire in monetary matters even during this century of individual freedom and enterprise. To regulate the people's money at least in matters of size and fineness was considered a proper function of government. And since governments were generally biased in favor of the largest possible money supply, which was thought to generate national wealth and prosperity, they favored a double

(11) Conant, Charles A., THE PRINCIPLES OF MONEY AND BANKING, N.Y.: Harper Bros., 1905, Vol. I, pp. 131, 132.

standard in which both gold and silver were legal money. But instead of letting both metals circulate side by side at ratios that were freely determined in the money market in accordance with demand and supply, governments felt called upon to regulate their mutual exchange ratios. And this regulation, which was price fixing of the metals in terms of each other, then gave birth to a single standard. In other words, the inevitable failure of the bimetallic standard due to the operation of Gresham's Law led to either the gold standard or silver standard. The fixed ratio between the two determined the outcome.

The early history of American currency clearly illustrates this circuitous road to the gold standard. With the establishment of the federal government a bimetallic standard was adopted, and the coinage ratio for silver and gold was fixed at 15 to 1. But this ratio overvalued silver and thus drove full-weight gold coins out of circulation. When Congress became cognizant of the disequilibrium in the specie currency, it endeavored to bring the country back to the bimetallic basis. An Act passed on June 28, 1834 reduced the gold content of the dollar from 24.75 grains of pure gold to 23.2 grains, but left the bullion content of the silver dollar unchanged. The reduction of the bullion content of the gold dollar changed the coinage ratio from 15 to 1

to approximately 16 to 1[12]. But just as the earlier ratio had overvalued silver, so did the new ratio overvalue gold. Consequently, in time gold began to replace silver as the standard money. True weight silver coins and silver bullion disappeared from circulation, the banks substituted gold reserves for silver specie, and a de facto gold standard emerged.

Substituting Gold for Fiat or Silver

Several European nations, such as Germany, Austria-Hungary, and Russia, travelled yet another road to the gold standard. Since Great Britain, the leader in world trade and finance, had a gold standard, many others aimed to follow. They achieved a transition from other standards, such as silver or irredeemable fiat, through substitution. In the case of Germany the government began to pay gold and claims to gold in exchange for the silver money and claims to silver money held by its citizens. The government, through the operations of its central bank, provided the necessary quantity of the new metal and exchanged it for the old currency.

---

(12) "Treasury Report on the Relative Value of Gold and Silver, May 4, 1830" and "The Devaluation Acts of June 28, 1834 and January 18, 1837," in Kraos', Herman E., DOCUMENTARY HISTORY OF BANKING AND CURRENCY IN THE UNITED STATES, New York: Chelsea House Publishers, 1969, Vol. II, pp. 994 et seq.

In other countries the transition was achieved with rather small quantities of gold by permitting the old money to remain in circulation. But the latter was changed into claims that were convertible into the new gold money made available by government.[13]

In recent decades most governments have worked fervently in the opposite direction: to sabotage and destroy the gold standard. They have, in fact, been so successful that the gold standard is practically extinct. Governments have seized complete control over the monetary systems, and government paper money has become the fiat standard money. It is true, governments still hold large quantities of gold and make calculations in gold. But they neither publicly redeem their paper notes in gold, nor tolerate the monetary use of gold by their citizens.

Three Variations

The decline of the gold standard in recent decades produced several variations.

The unadulterated standard which was later called the orthodox or classical gold standard was a *gold-coin standard*. Gold coins were actually in the cash

---

(13) Bamberger, Ludwig, *REICHSGOLD*, 1876, p. 179 et seq.; Menger, Carl, "Der Ubergang zur Goldwahrung" in the COLLECTED WORKS OF CARL MENGER, 1936, Vol. IV, p. 189 et seq.

holdings of the people in addition to bank notes, check book money, and fractional coins. The latter were money substitutes payable on demand in gold coins. It was immaterial that some notes were endowed with legal-tender power, that is, the legal power to settle all debts public and private. As long as they were redeemable on demand they represented definite quantities of the metal gold.

Since the beginning of this century governments began to restrict the actual circulation of gold. They gradually established the *gold-bullion standard,* which affords greater leeway for inflation and familiarizes the people with paper money. Under this standard the government is managing the bullion. Gold coins are no longer in circulation, having been accumulated in the vaults of central banks. The national currency is no longer redeemable in gold coins, but only in large, expensive gold bars. This, in effect, prevents redemption by most citizens and limits it to a few specialists in international trade and finance. During the 1920's several European countries had standards of this type.

The gold-standard system was undermined even more by the *gold-exchange standard.* Governments now began holding their country's gold reserves not in actual gold, but in foreign claims to gold. They were selling foreign currency that actually was redeemable in gold coin or gold bullion at rates that

reflected the legal parity. The world's monetary gold thus was gradually accumulated in a few central banks that became the reserve banks of the world.[14]

Immediately after World War II the Bank of England and the U.S. Federal Reserve System controlled most of the world's stock of monetary gold. More than 60 nations were holding their reserves in pound sterling claims to gold, forming the sterling area. Some twenty nations, mainly in Latin America belonged to the dollar area. But the Bank of England in turn was holding most of its reserves in dollar claims to gold, which made the Federal Reserve System the Ultimate reserve bank of the world and the gold-exchange standard a *de facto* dollar-*exchange* standard.

During the 1960's the decade of the New Frontier and Great Society, the U.S. dollar gradually fell from this position of predominance. Several monetary crises and runs from the British pound, which triggered world-wide demands for dollar redemption, greatly depleted the American stock of gold and created precarious payment situations. Therefore, in March 1968, most governments joined the British Government in halting gold redemption of

---

(14) Palyi, Melchior, THE TWILIGHT OF GOLD, Chicago: Henry Regnery Co., 1972, pp. 2-11, 112-146, 155-183.

their currencies, and introducing the "two-tier system." Gold payments were to be continued among governments and central banks while private claims for redemption were universally denied. But in reality also central banks exchanged very little gold thereafter. Thus ended the gold-exchange standard and began a world-wide fiat standard. The gates were flung wide open for more inflation.

A Standard Without Government

The gold-coin standard means sound money; it makes the value of money independent of government. It is true, it cannot achieve the unattainable ideal of an absolutely stable currency. There is no such thing as stability and unchangeability of purchasing power. But the gold standard protects the monetary system from the influence of governments as the quantity of gold in existence is utterly independent of the wishes and manipulations of government officials and politicians, parties and pressure groups. There are no "rules of the game," no arbitrary rules which people must learn to observe. It is a social institution that is controlled by inexorable economic law.

The issuers of money substitutes, whether private or public, keep their currencies at par with gold through unconditional redemption. Where there is a central bank it buys any amount of gold against

its currency or deposits at the parity rate, and sells indiscriminately and on demand any amount of gold against its notes or deposits. It thereby renders no national service, nor "defends" or "protects" the national currency. It merely fulfills the contract it made when it issued the money substitutes.

Under the gold-coin standard inflationary policies are not rendered impossible, but rather made difficult. Redemption demands and the threat of drains of their gold reserves would restrain the issuer of money substitutes from inflationary expansion. For any such expansion would alarm the owners of substitutes and cause them to demand redemption in gold coin, which would spell ruin to the issuer.[15]

An International Standard

The international gold standard evolved without intergovernmental treaties and institutions. No one had to make the gold standard work as an international system. When the leading nations of the world had adopted gold as their currency the world had an international money. It is true, the coins bore different names and had different weights. But

---

(15) See Rothbard, Murray N., "Money in a Free Society" in WHAT HAS GOVERNMENT DONE TO OUR MONEY, Colorado Springs: Pine Tree Press, 1963, pp. 1-26.

this hardly mattered as long as they consisted of gold and could be exchanged freely. After all, an ounce of gold is an ounce of gold whether it consists of eagles or sovereigns.

The gold standard united the world as international payments ceased to be a problem. It facilitated international trade and finance, and thereby promoted world-wide division of labor. Countries specialized in those internationally traded commodities in which they enjoyed the greatest advantage. But above all, the gold standard encouraged exportation of capital from the industrial countries to the backward areas. Without the fears of devaluation losses or transfer restrictions European capital eagerly sought profitable employment opportunities on all continents. It developed commerce and industry and thus improved the living conditions of millions of natives.

Countries with a gold standard had no balance-of-payments problems, no currency crises or runs as we experience them so often today. True, the United States suffered large exports of money and bullion, which in Mercantilist terminology is dubbed "unfavorable," during the 1850's and 1860's when large quantities of California gold entered the money markets and, during the Civil War, when even larger quantities of Greenbacks replaced the metallic money. But the reasons for the unfavorable balance

of payments were well understood: the growing quantities of money in circulation induced the people to reduce their cashholdings and buy more foreign goods instead.

Under the gold standard commercial banks and central banks kept their currencies at par with gold and foreign exchange through unconditional redemption. They bought at the parity rate any amount of gold against domestic banknotes and deposit currency. And they sold without discrimination any amount of gold at the parity rate. The gold standard thus united the world with trusted national currencies, which were mere money substitutes of the world medium: gold.

In all countries where gold was the standard money the exchange ratios between gold coins of different weight and fineness were determined simply by this difference. If one coin weighed one ounce and another coin of equal fineness only one-third of an ounce, the exchange ratio obviously was 1:3. Under the gold-coin standard commonly called the orthodox or classical gold standard, gold coins were the standard money. National currencies represented a certain quantity of gold of a certain fineness. The U.S. dollar, for example, consisted of 25.8 grains of gold, nine-tenths fine, before the 1934 devaluation, and of 15 5/21 grains thereafter, or in troy ounces 1/20.67 and 1/35 respectively.

The U. S. $20 gold coin (Double Eagle) contained 30.09312 grams of fine gold, the $10 coin (Eagle) 15.04656 grams, and the $5 coin (Half Eagle) 7.52328 grams. The British Sovereign contained 7.322 grams, the Mexican 50 Peso coin 37.5 grams, the French 20 Francs coin, also called Napoleon, 5.8 grams, and the Swiss 20 Francs coin 5.8 grams.[16] Exchange ratios between the various currency units consisting of gold thus were determined by their relative measures of gold.

Economic Stability

Inasmuch as the gold standard makes inflationary policies rather difficult, it avoids the wide fluctuations of economic activity, known as the business cycle. As it forces the issuers of money substitutes not to exceed very narrow limits, it is an efficient check on credit expansion. But it is this credit expansion that generates the economic boom and bust cycle.

When a central bank operating without the restraints of the gold standard creates new reserves for banks, which in turn extend credit to business, the entrepreneurs begin to expand production. But this expansion is based merely on banknotes and deposits. It lacks the real supply of capital goods,

(16) Cf. Franz Pick, CURRENCY YEARBOOK, Pick Publishing Corp., N. Y., 1970 pp. 13-15.

and therefore must finally collapse. When the prices of production factors begin to soar and business becomes unprofitable, when the central bank finally halts its inflation out of fear of run-away prices, the boom must come to a sudden end. It is followed by a recession which is a time of readjustment and correction.[17]

Professor William Graham Sumner, the great Yale economist of the pre-Federal Reserve era, summarized several American experiences with irredeemable paper currency as follows: "Scheme after scheme has been proposed and tried for realizing the gain which it was believed that cheap money could produce for the public; that is, for those who buy and use currency. This gain has been pursued as the alchemists pursued the philosopher's stone, by trial and failure. Whether there be any such gain or not, our attempts to win it have all failed, and they have cost us, in each generation, more than a purely specie currency would have cost, if each generation had had to buy it anew. . . . The revulsions to which the system was subject overwhelmed us in every decade. The notions on which the system was based are proved to have been delusions, disastrous to everybody concerned, including those

---

(17) von Mises, Ludwig, HUMAN ACTION, Yale University Press, 1949, 535 et seq.

vho tried to profit by them."[18]

The False Gold Standard

The gold-coin standard cannot be manipulated by overnment and, therefore, presents an insurmountble obstacle to all attempts at credit expansion and egulation through monetary policy. When it was radually replaced by the gold-bullion standard and inally by the gold-exchange standard, governments ssumed the power to manipulate their national urrency systems. The gold now "centralized" in overnment vaults was used solely to secure the tability of foreign exchange rates. Central bankotes which government had given legal tender uality took the place of coins in the cash holdings f the people. No one but the government was esponsible for the system. Even in the eyes of the ankers who, too, were creating money substitutes n the form of demand deposits, the government vas solely in charge. Everyone learned to rely on he central bank as the bank of "last resort." The old standard thus lost its eminent quality: its inlependence of government.[19]

The gold-exchange standard was a false gold

(18) Sumner, William Graham, HISTORY OF BANKING IN THE U.S., New York: The Journal of Commerce and Commercial Bulletin, 1896, p. 472.

(19) Palyi, Melchior, IBID., p. 112 et seq.

standard. The monetary gold was absorbed by a few central banks that exerted a decisive influence over the price of gold. For many years the price substantially depended on the decisions of a single government, that of the United States. With governments in control the national currencies depreciated in every country. Dozens of currency devaluations occurred nearly every year. In fact, the public learned to accept them as "insignificant" increases in the price of gold. The gold-exchange standard thus managed and manipulated was no longer a gold standard in the classical sense. It was a government standard that differed little from the fiat standard to which it finally gave way.

The Enemies of the Gold Standard

For some 200 years governments have tried to manipulate and regulate the people's choice of money. Since the gold standard was least amenable to government control it was systematically assaulted. It was suspended at government convenience, gradually deprived of its substance, and finally replaced by the fiat standard. The stage thus was set for an age of inflation.

Early opposition to the gold standard was voiced by the *classical economists*. They looked upon the costs of a metallic currency as a waste, which the gold exchange standard was said to reduce. They

blithely assumed that no government of a civilized nation would exploit the gold exchange standard for inflationary objectives. David Ricardo put it this way: "In a free country, with an enlightened legislature, the power of issuing paper money, under the requisite checks of convertibility at the will of the holder, might be safely lodged in the hands of commissioners appointed for that special purpose, and they might be made totally independent of the control of ministers."[20]

Several modern economists still echo this particular objection against the gold standard. But while we may understand the naivete of classical economists, who had never experienced hyper-inflations and devaluations in a free country, the modern economists cannot be exculpated so easily. They should know that, paraphrasing William Graham Sumner, a new gold-coin standard could be established every year out of the depreciation losses suffered by savers and creditors. And the needed gold could be purchased again and again from the losses suffered by the millions of victims of a depression. Indeed, *the gold coin standard is a bargain price for economic stability.* In an age of inflation and cur-

---

(20) Ricardo, David, PRINCIPLES OF POLITICAL ECONOMY AND TAXATION in "The Works and Correspondence of David Ricardo," ed. by Piero Sraffa, Vol. I, Cambridge, 1951, p. 362.

rency crises to reiterate confidence in the monetary integrity of government is to be deaf and blind to reality.

Ardent opposition to the gold standard is voiced by the *nationalists in all countries.* Favoring national autarky in all matters they resent their monetary dependence on gold. The fiat standard is their system.

The American representative resents the gold standard for two particular reasons. It puts gold into the center of the system to which all national currencies including the U.S. dollar must adjust. Without the standard that makes national currencies just money substitutes, the U.S. dollar would take the place of gold in the currency systems of most countries. At least, this is what our nationalists believe. American preponderance in the world capital markets and international trade, they say, would afford the dollar such an eminent position.

It is true, the gold-exchange standard made our Federal Reserve System the world central banker administering the world gold reserves. But the prominent position of the System was derived from its prominent holdings of gold. Without this gold the dollar standard would inevitably succumb to the gold standard, which emerges from inexorable economic law wherever there is freedom.

The nationalists also resent the gold standard be-

cause it places the U.S. in a most embarrasssing light. U. S. liquid liabilities to foreigners presently exceed $70 billion in gold, which is some $60 billion more than the U.S. Treasury can muster. If we cannot pay, the nationalist concludes, the fault must lie with the system. Let's abolish it rather than admit failure to "those international bankers."[21]

It is indeed difficult to admit that the accumulated payments deficits of more than $70 billion resulted from our own inflation predilection. For many years the U.S. Government has been generating the international payments deficits with reckless deficit spending and money creation.

But the most implacable enemies of the gold standard are the *inflationists*. To them federal spending and easy money are the panacea for all social and economic ills. They are the chronic

---

(21) Wide differences exist between the theoretical and ideological positions of various groups. There are American economists who long for the world supremacy of the U.S. dollar. All other national currencies are to revolve around it. Other writers reject gold because the U.S. is not self-sufficient in its production. Large quantities would have to be imported from abroad, especially South Africa and the Soviet Union, if the American people were permitted to use gold as *medium of exchange*. Some *nationalists decry gold* merely because its market is made by the bankers of London, Zurich, Paris and Frankfurt, rather than those of New York.

spenders who find it so difficult to live on tax revenue only. Year after year they prompt the federal government to incur budgetary deficits that are most conveniently covered by new money. Their opposition to the gold standard usually is depicted as a desire for "freedom for each country to pursue a monetary and fiscal policy of social welfare and justice."

There are also the apostles of credit expansion as a means for full employment and economic growth. They are convinced that newly created credit can lower interest rates, give employment and raise wages. And in recent years they even extended their boundless faith in easy money to economic expansion and development. Economic growth, they say, requires more money than the gold standard can possibly provide.[22]

---

(22) Cf. Hansen, Alvin H., A GUIDE TO KEYNES, New York: McGraw-Hill, 1953, pp. 21-22; also MONETARY THEORY AND FISCAL POLICY, New York: Mc Graw-Hill, 1949; BUSINESS CYCLES AND NATIONAL INCOME, New York: W.W. Norton, Inc., 1951; Samuelson, Paul, ECONOMICS, 8th ed., New York: McGraw-Hill, 1970; Lerner, A.P., ESSAYS IN ECONOMIC ANALYSIS, London: McMillan & Co., Ltd., 1953; Galbraith, John Kenneth, THE NEW INDUSTRIAL STATE, Boston: Houghton Mifflin Co., 1967; THE AFFLUENT SOCIETY, Houghton Mifflin Co., 1958; AMERICAN CAPITALISM, Houghton Mifflin Co., 1952; ECONOMIC DEVELOPMENT, Cambridge, Mass.: Harvard University Press, 1962.

It is true, the gold standard does not afford supplementary revenue to governments. But the stated objectives, such as economic expansion and full employment, social welfare and justice, not only do not require inflation, but even presuppose its absence. Economic growth depends on the accumulation of capital through savings and profits. Full employment results from the proper adjustment of labor costs to labor productivity. And social welfare and justice depend on sound money — inflation merely compounds economic and social evils. This is why ages of inflation are also marked by social and political unrest, by strife and conflict, riots and revolutions.

The most consistent foes of the gold standard are the *socialists* and *communists*. Their very raison d'etre is government control and direction of all phases of economic life. How can they tolerate the gold standard, which springs from individual freedom and private property? Gold coins are a medium of exchange — but there is no free exchange in a command economy. To believe that Soviet Russia will ever tolerate gold markets and gold payments is to believe that she will abolish the Soviets and turn laissez-faire.

Popular Fallacies

The gold standard is the currency system of free

people who exchange their goods and services for gold, their common medium of exchange. The actual use of gold coins affords a measure of protection from inflationary policies, which all kinds of government are so prone to practice. But, contrary to the shallow charges by many foes, no gold standard advocate expects it to protect man from his own follies. It is merely a manifestation of civil liberty, a phenomenon of the market economy, but no panacea for political, social and economic evils.

It would be extremely naive to believe that a government bent on spending and inflating would tolerate the gold standard, or that interventionists and socialists would willingly forego their power over money and credit. This would be as naive as to believe that war can be outlawed among nations bent on waging war, or that dictatorships can be made unconstitutional for people who want to be led. The gold standard presupposes individual freedom, private property, and free markets.

Some foes of the gold standard, who usually profess a preference for the market system, contend that the choice of monetary system is a purely technical question. The monetary arrangement that is most workable on technical grounds, whether fiat money or gold standard, is said to deserve our preference. It is significant that these economists then promptly conclude, "on purely scientific grounds,"

that the fiat standard is more "workable" and therefore more desirable.[23]

It is undoubtedly true that the fiat standard is more workable for economic planners and money managers. But this is the very reason why we prefer the gold standard. Its excellence is its unmanageability by government. And we also deny that the fiat standard which is characterized by rapid self-destruction and has failed wherever it was tried, compares favorably on purely scientific grounds with the gold standard which is as old as man's civilization. Out of the ashes of fiat money the gold standard always springs anew because it is no technical creation of a few expert advisors, but a social institution that flows from economic freedom and economic law.

The most popular objection against the gold standard rests on the notion that there is just not

---

23 E.g. Yeager, Leland B., INTERNATIONAL MONETARY RELATIONS, N.Y.: Harper & Row, 1966, p. 493. According to Yeager, the typical academic supporter of the gold standard has not gone much "beyond sloganizing." Only the advocates of fiat money are *engaged in serious scientific discussion.* IBID., p. 481. Cf. also Friendman, Milton, STUDIES IN THE QUANTITY THEORY OF MONEY, Chicago: University of Chicago Press, 1956; A PROGRAM FOR MONETARY STABILITY, Chicago: University of Chicago Press, 1953; THE OPTIMUM QUANTITY OF MONEY AND OTHER ESSAYS, Chicago: Aldine Pub. Co., 1969.

enough gold in the world to accommodate the monetary needs of mankind. How can $68 billion in paper currency held by the American public be redeemed by some $10 billion of gold held by the U. S. Treasury? And how can some $207 billion of demand deposits be payable in gold?

The answer is simple. The fiat money now in the cash holdings of the people must stay in circulation. It must not be replaced by gold, but be permitted to function as money side by side with gold. For hundreds of years both gold coins and silver coins served simultaneously as money. It is true, their exchange ratio varied greatly over the centuries. But one metal does not replace the other as long as eager governments did not fix their prices and set into operation Gresham's law.

Return to the Gold Standard

How can a rebirth of the gold be achieved under present conditions? And how would it work?

No reasonable economist would want to revolutionize economic life through a radical monetary reform. He does not want to make gold the only money, forbidding government issue of any kind and suppressing banknotes and demand deposits used as media of exchange. Such a reform would require radical government intervention and greatly reduce the country's money supply. Prices and

wages would have to be drastically cut, which no modern society could withstand in an orderliy fashion.

The answer to our questions can be found in 3,000 years of experience with the gold standard. How did it emerge in the past? As described above, it arose from three different situations: unadultered monetary freedom, failure of the bimetallic standard, and government substitution of gold for other monies.

The last avenue was chosen by a few nations who endeavored to imitate the financial success and progress of the gold standard nations. When the industrialized countries, such as England and France, prospered with the gold standard, others adopted it through quick substitution. Their approach was that of latecomers who for good reasons imitated the successful leader. It is obvious that in an age of fiat money this avenue to the gold standard is closed for lack of a leader. And it is rather unrealistic to expect the U. S. Government to provide this leadership. It would have to renounce its inflationary ways and, at heavy expense, substitute gold coins for Federal Reserve notes while it owes more than $70 billion in gold to foreign creditors.

Most Western nations arrived at the gold standard via the bimetallic standard. Similarly, a double standard in which both gold and fiat money are

legal money could be used to re-establish the gold standard. But it requires the cooperation of government which an administration indulging in deficit spending is unlikely to provide. It would have to abandon any further inflation and prevent any further expansion of money substitutes. At the same time all restrictions on gold trading would have to be repealed, which would permit a free market for gold to emerge.

A free American gold market would probably result in an inflow of considerable quantities of foreign gold as many Americans would want to own some gold. After some oscillation on the market the price of gold would stabilize. Let us assume it to be $100 per ounce.

If the government now decrees that both Federal Reserve money and gold are legal money we are on a double standard. If the government establishes a legal parity of the dollars to gold at any ratio other than 100 to 1 it brings into operation Gresham's Law. That is, artifically overvalued money tends to drive artifically undervalued money out of circulation. Let us say, the government sets a ratio of 105 to 1, or even 110 to 1. It obviously overvalues the gold and thereby creates the gold standard. Gold gradually replaces government money in the people's cash holdings.

This road to the gold standard is rather circuitous.

Nevertheless, as it makes few demands on government it has been the most travelled road during the last 200 years. The U. S. Government used it in 1834.

Ludwig von Mises, the great dean of monetary theory, would establish the gold standard without this circuitousness. He would, once the market price of gold has been found, adopt this price as the new legal parity of the U. S. dollar and secure its unconditional convertibility at this parity. A new "conversion agency" would sell gold bullion to the public against paper dollars, and buy any amount of gold offered at the legal parity. Finally, transition from this gold-bullion standard to the gold-coin standard would be achieved by the U. S. Treasury exchanging all five, ten, and perhaps also twenty dollar bills against newly minted gold coins.[24]

This proposal for reform is most comprehensive and complete, as it envisions creation of a classical gold-coin standard by a single law. Of course, it assumes a state of economic and political enlightenment that surpasses by far the present state of economic and political thought.

Restoration of the gold standard may be a long and arduous task. As it was lost in a gradual erosion

---

(24) Mises, Ludwig von, THE THEORY OF MONEY AND CREDIT, The Foundation for Economic Education, Inc., Irvington-on-Hudson, N.Y. 1971, p. 435.

of monetary freedom we may have to retrieve it slowly and painstakingly on the road back to freedom, which gives it birth and meaning through inexorable economic law. This is why we seek no reform law, no restoration law, no conversion or parity, no government cooperation, merely freedom.

The road is short and direct. And yet, depending on the resistance offered by popular ignorance and prejudice, by government greed and lust of power, it may take us many years to traverse. For the weary traveler it has several intermediary stops that provide convenient targets for supreme effort.

The first objective must be *the freedom to trade and hold gold.* Everyone must be free to buy and sell, to lend and to borrow, to import and export any quantity of gold, to hold it at home or abroad, whether minted or unminted. There must be no government interference with the gold markets, no regulation or controls, no taxation or dictation that would sabotage the gold markets. Dozens of nations in all continents actually enjoy this rudimentary freedom. Americans lost it "temporarily" in 1933 when the Roosevelt Administration seized all private gold holding.

The next objective must be *the individual freedom to use gold in all economic exchanges.* The people must be free to buy gold by selling their goods and services for it, and to sell gold when

they buy goods and services, without the interaction of government money. That is to say, the legal tender law which decrees that government money must be accepted in payment of all debt public and private must exempt "gold contracts" and "gold clauses" that specifically call for payment of certain measures of gold. In short, the ordinary law of contract must be permitted to function.

At this point we have arrived at the "parallel standard." It would not in the least curtail government operations or impede government finance. The Federal Reserve System could continue its operations, its inflation and credit expansion, and the U. S. Treasury would receive taxes and make payments in Federal Reserve money. All contracts stated in U. S. dollars would have to be met in U. S. dollars; but contracts stated in ounces and grains of gold would have to be met in gold. Government money and gold would be circulating side by side. The relative supplies of and demands for the two monies would determine their exchange ratio, which would continually fluctuate in response to demand and supply.

The third objective on the road to the gold standard would be the *individual freedom to mint coins.* The first coins were minted by private individuals and goldsmiths. And private coins have circulated throughout history, in California as late

as 1848. As these coins would not be endowed with "legal tender," no one would be obliged to accept them in payment of a debt. He who would deem them too much trouble to weigh or test, or would distrust the minter's stamp and guarantee, would be free to use Federal Reserve notes. After all, only Federal Reserve money would be legal tender except where gold payment is contractually required.

The fourth and final phase is not really vital for the restoration of the gold standard. An enlightened government may at this time decide to make its own money freely convertible into gold. It may adopt the going exchange ratio between the two as the legal parity and then secure unconditional *convertibility* of its money into gold. This phase which does not materially enhance our monetary freedom would merely legalize the gold standard that would gradually emerge on the road to freedom.

Step by step the federal government has assumed control over our monetary system. It thus captured a potent source of revenue and a vital command post over the economic lives of its people. This is why every friend of freedom is dedicated to the restoration of free money which is also sound money. It is the gold standard.

About the author: Hans Sennholz was born in Germany, and earned an MA from the University of Marburg and a doctorate from the Univesity of Cologne. After emigrating to the USA he took a PhD in economics from New York University. He is known as one of the outstanding disciples of Ludwig von Mises and has written more than 200 books, articles and treatises published in the U. S. and elsewhere. Dr. Sennholz is Chairman of the Department of Economics at Grove City College, Pennsylvania.

BRAMBLE MINIBOOKS

P. O. Box 836 • Lansing, MI 48904