

The Case for a Genuine Gold Dollar

Murray N. Rothbard



The Gold Standard: Perspectives in the Austrian School. Edited with an Introduction by Llewellyn H. Rockwell, Jr. Copyright © 1992. The Ludwig von Mises Institute. Auburn, Ala. Pp. 116-130; *The Gold Standard: An Austrian Perspective.* Lexington, MA: D.C. Heath, 1985, pp. 1-17; Reprinted in *The Logic of Action One: Method, Money, and the Austrian School.* Glos, UK: Edward Elgar Publishing Ltd., 1997, pp. 364-383.

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Inflationary Fiat Paper

For nearly a half-century the United States and the rest of the world have experienced an unprecedented continuous and severe inflation. It has dawned on an increasing number of economists that the fact that over the same half-century the world has been on an equally unprecedented fiat paper standard is no mere coincidence. Never have the world's moneys been so long cut off from their metallic roots. During the century of the gold standard from the end of the Napoleonic wars until World War I, on the other hand, prices generally fell year after year, except for such brief wartime interludes as the Civil War.¹ During wartime, the central governments engaged in massive expansion of the money supply to finance the war effort. In peacetime, on the other hand, monetary expansion was small compared to the outpouring of goods and services attendant upon rapid industrial and economic development. Prices, therefore, were normally allowed to fall. The enormous expenditures of World War I forced all the warring governments to go off the gold standard,² and unwillingness to return to a genuine gold standard eventually led to a radical shift to fiat paper money during the financial crisis of 1931-33.

It is my contention that there should be no mystery about the unusual chronic inflation plaguing the world since the 1930s. The dollar is the American currency unit (and the pound sterling, the franc, the mark, and the like, are equivalent national currency units), and since 1933, there have been no effective restrictions on the issue of these currencies by the various nation-states. In effect, each nation-state, since 1933, and especially since the end of all gold redemption in 1971, has had the unlimited right and power to create paper currency which will be legal tender in its own geographic area. It is my contention that if any person or organization ever obtains the monopoly right to create money, that person or organization will tend to use this right to the hilt. The reason is simple: Anyone or any group empowered to manufacture money virtually out of thin air will tend to exercise that right, and with considerable enthusiasm. For the power to create money is a heady and profitable privilege indeed.

The essential meaning of a fiat paper standard is that the currency unit—the dollar, pound, franc, mark, or whatever—consists of paper tickets, marked as "dollars," "pound," and so on, and manufactured by the central government of the nation-state.³ The government (or its central bank) is able to manufacture those tickets *ad libitum* and essentially costlessly. The cost of the paper and the printing is invariably negligible compared to the value of the currency printed. And if, for some

¹ The exception was the period 1896-1914, when a mild chronic inflation (approximately 2 percent per year) resulted from unusual gold discoveries, in Alaska and South Africa.

² With the exception of the United Sta[t]es, which entered the war in the spring of 1917, two and a half years after the other belligerents. But even the United States went informally off the gold standard by prohibiting the export of gold for the duration of the war.

³ In olden days, the paper tickets were issued by the central government's Treasury (e.g., Continentals in the American Revolutionary war, *assignats* during the French Revolution, greenbacks during the American Civil War). Nowadays, in a more complex variant of the system, the tickets constituting the monetary "standard" are issued by the government's central bank.

reason, such cost is not negligible, the government can always simply increase the denominations of the bills!

It should be clear that the point of the government's having the power to print money is to monopolize that power. It would simply not do to allow every man, woman, and organization the right to print dollars, and so the government invariably guards its monopoly jealously. It should be noted that government is never so zealous in suppressing crime as when that crime consists of direct injury to its own sources of revenue, as in tax evasion and counterfeiting of its currency. If counterfeiting of currency were not illegal, the nation's supply of dollars or francs would rise toward infinity very rapidly, and the purchasing power of the currency unit itself would be effectively destroyed.⁴

In recent years an increasing number of economists have understandably become disillusioned by the inflationary record of fiat currencies. They have therefore concluded that leaving the government and its central bank power to fine tune the money supply, but abjuring them to use that power wisely in accordance with various rules, is simply leaving the fox in charge of the proverbial henhouse. They have come to the conclusion that only radical measures can remedy the problem, in essence the problem of the inherent tendency of government to inflate a money supply that it monopolizes and creates. That remedy is no less than the strict separation of money and its supply from the state.

Hayek's "Denationalization" of Money

The best known proposal to separate money from the state is that of F.A. Hayek and his followers.⁵ Hayek's "denationalization of money" would eliminate legal tender laws, and allow every individual and organization to issue its own currency, as paper tickets with its own names and marks attached. The central government would retain its monopoly over the dollar, or franc, but other institutions would be allowed to compete in the money creation business by offering their own brand name currencies. Thus, Hayek would be able to print Hayeks, the present author to issue Rothbards, and so on. Mixed in with Hayek's suggested legal change is an entrepreneurial scheme by which a Hayek-inspired bank would issue "ducats," which would be issued in such a way as to keep prices in terms of ducats constant. Hayek is confident that his ducat would easily out-compete the inflated dollar, pound, mark, or whatever.

Hayek's plan would have merit if the thing—the commodity—we call "money" were similar to all other goods and services. One way, for example, to get rid of the inefficient, backward, and sometimes despotic U.S. Postal Service is simply to abolish it; but other free market advocates propose the less radical plan of keeping the post office intact but allowing any and all organizations to compete with it. These economists are confident that private firms would soon be able to outcompete the post office. In the past decade, economists have become more sympathetic to deregulation and free competition, so that superficially denationalizing or allowing free

⁴ Note that we are assuming that standard paper is legal tender, as indeed all government money now is. (That is, all creditors are compelled to accept the paper tickets in payment for money debt.) In our hypothetical scenario, all individual tickets marked "dollars" or "francs" would similarly possess legal tender power.

⁵ See, in particular, F. A. Hayek, *The Denationalisation of Money* (London: The Institute of Economic Affairs, 1976).

competition in currencies would seem viable in analogy with postal services or fire-fighting or private schools.

There is a crucial difference, however, between money and all other goods and services. All other goods, whether they be postal service or candy bars or personal computers, are desired for their own sake, for the utility and value that they yield to consumers. Consumers are therefore able to weigh these utilities against one another on their own personal scales of value. Money, however, is desired not for its own sake, but precisely because it *already* functions as money, so that everyone is confident that the money commodity will be readily accepted by any and all in exchange. People eagerly accept paper tickets marked "dollars" not for their aesthetic value, but because they are sure that they will be able to sell those tickets for the goods and services they desire. They can only be sure in that way when the particular name, "dollar," is *already* in use as money.

Hayek is surely correct that a free market economy and a devotion to the right of private property requires that everyone be permitted to issue whatever proposed currency names and tickets they wish. Hayek should be free to issue Hayeks or ducats, and I to issue Rothbards or whatever. But issuance and *acceptance* are two very different matters. No one will accept new currency tickets, as they well might new postal organizations or new computers. These names will not be chosen as currencies precisely because they have not been used as money, or for any other purpose, before.

Hayek and his followers have failed completely to absorb the lesson of Ludwig von Mises' "regression theorem," one of the most important theorems in monetary economics.⁶ Mises showed, as far back as 1912, that since no one will accept any entity as money unless it had been demanded and exchanged earlier, we must therefore logically go back (regress) to the first day when a commodity became used as money, a medium of exchange. Since by definition the commodity could not have been used as money before that first day, it could only be demanded because it had been used as a nonmonetary commodity, and therefore had a preexisting price, even in the era before it began to be used as a medium. In other words, for any commodity to become used as money, it must have originated as a commodity valued for some nonmonetary purpose, so that it had a stable demand and price before it began to be used as a medium of exchange. In short, money cannot be created out of thin air, by social contract, or by issuing paper tickets with new names on them. Money has to originate as a valuable nonmonetary commodity. In practice, precious metals such as gold or silver, metals in stable and high demand per unit weight, have won out over all other commodities as moneys. Hence, Mises' regression theorem demonstrates that money must originate as a useful nonmonetary commodity on the free market.

But one crucial problem with the Hayekian ducat is that no one will take it. New names on tickets cannot hope to compete with dollars or pounds which originated as units of weight of gold or silver and have now been used for centuries on the market as the currency unit, the medium of exchange, and the instrument of monetary calculation and reckoning.⁷

⁶ For his regression theorem, see Ludwig von Mises, *The Theory of Money and Credit*, 2nd ed. (New Haven, Conn.: Yale University Press, 1953), pp. 170-86. Also see Murray N. Rothbard, *The Case for a 100 Percent Gold Dollar* [1962] (Washington, D.C.: Libertarian Review Press, 1974), pp. 10-11.

⁷ We might apply to Hayek's scheme the sardonic words of the nineteenth-century French economist Henri

Hayek's plan for the denationalization of money is Utopian in the worst sense: not because it is radical, but because it would not and could not work. Print different names on paper all one wishes, and these new tickets still would not be accepted or function as money; the dollar (or pound or mark) would still reign unchecked. Even the removal of the legal tender privilege would not work, for the new names would not have emerged out of useful commodities on the free market, as the regression theorem demonstrates they must. And since the government's own currency, the dollar and the like, would continue to reign unchallenged as money, money would not have been denationalized at all. Money would still be nationalized and a creature of the state; there would still be no separation of money and the state. In short, even though hopelessly Utopian, the Hayek plan would scarcely be radical enough, since the current inflationary and state-run system would be left intact.

Even the variant on Hayek whereby private citizens or firms issue gold coins denominated in grams or ounces would not work, and this is true even though the dollar and other fiat currencies originated centuries ago as names of units of weight of gold or silver.⁸ Americans have been used to using and reckoning in "dollars" for two centuries, and they will cling to the dollar for the foreseeable future. They will simply not shift away from the dollar to the gold ounce or gram as a currency unit. People will cling doggedly to their customary names for currency; even during runaway inflation and virtual destruction of the currency, the German people clung to the "mark" in 1923 and the Chinese to the "yen" in the 1940s. Even drastic revaluations of the runaway currencies which helped end the inflation kept the original "mark" or other currency name.

Hayek brings up historical examples where more than one currency circulated in the same geographic area at the same time, but none of the examples is relevant to his "ducat" plan. Border regions may accept two *governmental* currencies,⁹ but each has legal tender power, and each had been in lengthy use within its own nation. Multicurrency circulation, then, is not relevant to the idea of one or more new private paper currencies. In addition, Hayek might have mentioned the fact that in the United States, until the practice was outlawed in 1857, foreign gold and silver coins as well as private gold coins, circulated as money side by side with official coins. The fact that the Spanish silver dollar had long circulated in America along with Austrian and English specie coins, permitted the new United States to change over easily from pound to dollar reckoning. But again, this situation is not relevant, because all these coins were different weights of gold and silver, and none was fiat government money. It was easy, then, for people to refer the various values of the coins back to their gold or silver weights. Gold and silver had of course long circulated as money, and the pound sterling or dollar were simply different weights of one or the other metals. Hayek's plan is a very different one: the issue of private paper tickets marked by new names and in the hope that they are accepted as money.

Cernuschi, which Mises approvingly cited in a slightly different context: "I want to give everybody the right to issue banknotes so that nobody should take banknotes any longer." Ludwig von Mises, *Human Action* (New Haven, Conn.: Yale University Press, 1949), p. 443.

⁸ Thus, the pound sterling originated, *pace* its name, as a definition of one pound weight of silver, and the dollar originated as an ounce coin of silver in Bohemia. Much later, the "dollar" became defined as approximately 1/20 of an ounce of gold.

⁹ In Luxemburg, *three* government currencies—those of France, West Germany, and Luxemburg itself—circulate side by side.

If people love and will cling to their dollars or francs, then there is only one way to separate money from the state, to truly denationalize a nation's money. And that is to denationalize the *dollar* (or the mark or franc) itself. Only privatization of the dollar can end the government's inflationary dominance of the nation's money supply.

How, then, can the dollar be privatized or denationalized? Obviously not by making counterfeiting legal. There is only one way: to link the dollar once again to a useful market commodity. Only by changing the definition of the dollar from fiat paper tickets issued by the government to a unit of weight of some market commodity, can the function of issuing money be permanently and totally shifted from government to private hands.

The "Commodity Dollar": A Critique

If it is imperative that the dollar be defined once again as a weight of a market commodity, then what commodity (or commodities) should it be defined as, and what should be the particular weight in which it is set?

In reply, I propose that the dollar be defined as a weight of a single commodity, and that that commodity be gold. Many economists, beginning with Irving Fisher at the turn of the twentieth century, and including Benjamin Graham and an earlier F.A. Hayek, have hankered after some form of "commodity dollar," in which the dollar is defined, not as a weight of a single commodity, but in terms of a "market basket" of two or many more commodities.¹⁰ There are many deep-seated flaws in this approach. In the first place, such a market-basket currency has never emerged spontaneously from the workings of the market. It would have to be imposed (to use a derogatory term from Hayek himself) as a "constructivist" scheme from the top, from government to be inflicted upon the market. Second, and as a corollary, the government would be obviously in charge, since a market-basket currency does not, unlike the use of units of weight in exchange, arise from the free market itself. The government could and would, then, alter the ratios of weights, adjust the various fixed terms, and so forth. Third, the hankering for a fixed market basket is an outgrowth of a strong desire for the government to regulate the economy so as to keep the "price level" constant. As we have seen, the natural tendency of the free market is to lower prices over time, in accordance with growing productivity and increased supplies of goods. There is no good reason for the government to interfere. Indeed, if it does so, it can only create a boom-and-bust business cycle by expanding credit to keep prices artificially higher than they would be on the free market.

Furthermore, there are other grave problems with the commodity-basket approach. There is, for one thing, no such unitary entity as "the price level" which would be kept constant. The entire concept of price level is an artificial construction masking the fact that it can only consist of individual prices, each varying continually in relation to each other.

Irving Fisher's intense desire for a constant price level stemmed from his own fallacious philosophic notion that, just as science is based upon measurable standards (such as a yard comprising 36 inches), so money is supposed to be a measure of values and prices. But since there

¹⁰ In fact, even Hayek's current "ducat" scheme incorporates a commodity-basket plan. His proposed bank would fine tune the supply of ducats so as to keep the "price level" in terms of ducats always constant.

is no single price level, his very idea, far from being scientific, is a hopeless chimera. The only scientific measurement that properly applies is the currency unit as a true measure of *weight* of the money commodity. Furthermore, the only scientific measure is a definition which, once selected, remains eternally the same: "the pound," or "the yard." Juggling definitions of weight within a market basket violates any proper concept of definition or of measure.¹¹

A final and vital flaw in a market-basket dollar is that Gresham's law would result in perpetual shortages and surpluses of different commodities within the market basket. Gresham's law states that any money overvalued by the government (in relation to its market value) will drive out of circulation money undervalued by the government. In short, control of exchange rates has consequences like any other price control: A maximum rate below the free market causes a shortage; a minimum rate set above the market will cause a surplus. From the origin of the United States, the currency was in continuing trouble because the United States was on a bimetallic rather than a gold standard, in short a market basket of two commodities, gold and silver. As is well known, the system never worked, because at one time or another, one or the other precious metal was above or below its world market valuations, and hence one or the other coin or bullion was flowing into the country while the other would disappear. In 1873 partisans of the monometallic gold standard, seeing that silver was soon to be overvalued and hence on the point of driving out gold, put the United States on a virtual single gold standard, a system that was ratified officially in 1900.¹²

¹¹ For an outstanding philosophical critique of Fisher's commodity dollar, see the totally neglected work of the libertarian political theorist Isabel Paterson. Thus, Paterson writes:

As all units of measure are determined arbitrarily in the first place, though not fixed by law, obviously they can be altered by law. The same length of cotton would be designated an inch one day, a foot the next, and a yard the next; the same quantity of precious metal could be denominated ten cents today and a dollar tomorrow. But the net result would be that figures used on different days would not mean the same thing; and somebody must take a heavy loss. The alleged argument for a "commodity dollar" was that a real dollar, of fixed quantity, will not always buy the same quantity of goods. Of course it will not. If there is no medium of value, no money, neither would a yard of cotton or a pound of cheese always exchange for an unvarying fixed quantity of any other goods. It was argued that a dollar ought always to buy the same quantity of and description of goods. It will not and cannot. That could occur only if the same number of dollars and the same quantities of goods of all kinds and in every kind were always in existence and in exchange and always in exactly proportionate demand; while if production and consumption were admitted, both must proceed constantly at an equal rate to offset one another.

Isabel Paterson, *The God of the Machine* (New York: Putnam, 1943), p. 203n.

¹² Specifically, the Coinage Act of 1792 defined the "dollar" as *both* a weight of 371.25 grains of pure silver and a weight of 24.75 grains of pure gold—a fixed ratio of 15 grains of silver to 1 grain of gold. This 15:1 ratio was indeed the world market ratio during the early 1790s, but of course the market ratio was bound to keep changing over time, and thus bring about the effects of Gresham's law. Soon an increased silver production led to a steady decline of silver, the market ratio falling to 15.75:1. As a result, silver coins flooded into the United States, and gold coins flooded out. Silver remained the sole circulating coinage, until the Jacksonians in 1834 successfully brought back gold by debasing the gold weight of the dollar to 23.2 grains, lowering the weight by 6.26 percent. At this new ratio of 16:1, gold and silver circulated side by side for two decades, when the discovery of new gold mines in California, Russia, and Australia, greatly increased gold production, and sent the market ratio down to 15.3:1. As a result, gold coin poured in and silver flowed out of the country. The United States continued on a *de facto* gold monometallic standard, but a *de jure* bimetallic standard from the 1850s, with the market ratio holding at about 15.5:1 while the official mint ratio was 16:1.

By 1872, however, a few knowledgeable officials at the U.S. Treasury realized that silver was about to suffer a huge decline in value, since the European nations were shifting from a silver to a gold standard, thereby decreasing their demand for silver and increasing their demand for gold, and because of the discovery of the new silver mines in

One argument used by Fisher, James M. Buchanan, and others holds that the U.S. Constitution mandates the government's using its powers to stabilize the price level. This argument rests on Article I, Section 8 of the Constitution, which gives Congress the power "to coin money, regulate the value thereof..." The argument, absurd at best, disingenuous at worst, and certainly anachronistic treats the framers of the Constitution as if they were modern price-stabilizationist economists, as if they meant by "the value thereof" the purchasing power of the money unit, or its inverse, the price level. From this dubious assumption, these writers derive the alleged constitutional duty of the federal government to intervene in monetary matters so as to stabilize the level of prices. But what the framers meant by "value" was simply the weight and the fineness of coins. It is, after all, the responsibility of every firm to regulate the nature of its own product, and to the extent that the federal government mints coins, it must see to it that the weight and fineness of these coins are what the government says they are.

The Case for a Gold Dollar

We conclude, then, that the dollar must be redefined in terms of a single commodity, rather than in terms of an artificial market basket of two or more commodities. Which commodity, then, should be chosen? In the first place, precious metals, gold and silver, have always been preferred to all other commodities as mediums of exchange where they have been available. It is no accident that this has been the invariable success story of precious metals, which can be partly explained by their superior stable nonmonetary demand, their high value per unit weight, durability, divisibility, cognizability, and the other virtues described at length in the first chapter of all money and banking textbooks published before the U.S. government abandoned the gold standard in 1933. Which metal should be the standard, then, silver or gold? There is, indeed, a case for silver, but the weight of argument holds with a return to gold. Silver's increasing relative abundance of supply has depreciated its value badly in terms of gold, and it has not been used as a general monetary metal since the nineteenth century. Gold was *the* monetary standard in most countries until 1914, or even until the 1930s. Furthermore, gold was the standard when the U.S. government in 1933 confiscated the gold of all American citizens and abandoned gold redeemability of the dollar, supposedly only for the duration of the depression emergency. Still further, gold and not silver is still considered a monetary metal everywhere, and governments and their central banks have managed to amass an enormous amount of gold not now in use, but which again could be used as a standard for the dollar, pound, or mark.

This brings up an important corollary. The United States, and other governments, have in effect nationalized gold. Even now, when private citizens are allowed to own gold, the great bulk of that metal continues to be sequestered in the vaults of the central banks.¹³ If the dollar is redefined in terms of gold, gold as well as the dollar can be jointly denationalized. But if the dollar is *not*

Nevada and other Mountain states. To keep the de facto gold standard, the Treasury slipped bills through Congress in 1873 and 1874, discontinuing the minting of any further silver dollars, and ending the legal tender quality of silver dollars above the sum of \$5. This demonetization of silver meant that, when, in 1874, silver began a rapid market ratio decline above 16:1 and finally to 32:1 in the 1890s, silver coins would not flow into the country and gold would not flow out. Finally, in 1900, the dollar was defined de jure solely in terms of gold, at 23.22 grains.

See Ron Paul and Lewis Lehrman, *The Case for Gold* (Washington, D.C.: Cato Institute, 1982), pp. 17-19, 30-32, 60-66, 100-2.

¹³ In the United States, the Treasury holds the gold in trust for the Federal Reserve Banks at its depositories at Fort Knox and elsewhere.

defined as a weight of gold, then how can a denationalization of gold ever take place? Selling the gold stock would be unsatisfactory, since this (1) would imply that the government is entitled to the receipts from the sale and (2) would leave the dollar under the absolute fiat control of the government.

It is important to realize what a definition of the dollar in terms of gold would entail. The definition must be *real* and effective rather than nominal. Thus, the U.S. statutes define the dollar as 1/42.22 gold ounce, but this definition is a mere formalistic accounting device. To be real, the definition of the dollar as a unit of weight of gold must imply that the dollar is interchangeable and therefore redeemable by its issuer in that weight, that the dollar is a demand claim for that weight in gold.

Furthermore, once selected, the definition, whatever it is, must be fixed permanently. Once chosen, there is no more excuse for changing definitions than there is for altering the length of a standard yard or the weight of a standard pound.

Before proceeding to investigate what the new definition or weight of the dollar should be, let us consider some objections to the very idea of the government setting a new definition. One criticism holds it to be fundamentally statist and a violation of the free market for the government, rather than the market, to be responsible for fixing a new definition of the dollar in terms of gold. The problem, however, is that we are now tackling the problem in midstream, *after* the government has taken the dollar off gold, virtually nationalized the stock of gold, and issued dollars for decades as arbitrary and fiat money. Since government has monopolized issue of the dollar, and confiscated the public's gold, only government can solve the problem by jointly denationalizing gold and the dollar. Objection to government's redefining and privatizing gold is equivalent to complaining about the government's repealing its own price controls because repeal would constitute a governmental rather than private action. A similar charge could be leveled at government's denationalizing any product or operation. It is not advocating statism to call for the government's repeal of its own interventions.

A corollary criticism, and a favorite of monetarists, asks why gold standard advocates would have the government "fix the (dollar) price of gold" when they are generally opposed to fixing any other prices. Why leave the market free to determine all prices *except* the price of gold?

But this criticism totally misconceives the meaning of the concept of price. A "price" is the quantity exchanged of one commodity on the market in terms of another. Thus, in barter, if a package of six light bulbs is exchanged on the market for one pound of butter, then the price per light bulb is one-sixth of a pound of butter. Or, if there is monetary exchange, the price of each light bulb will be a certain weight of gold, or, these days, numbers of cents or dollars. The important point is that price is the ratio of quantities of *two commodities* being exchanged. But if money is on a gold standard, the dollar and gold will no longer be two independent commodities, whose price should be free to fluctuate on the market. They will be *one* commodity, one a unit of weight of the other. To call for a "free market" in the "price of gold" is as ludicrous as calling for a free market of ounces in terms of pounds, or inches in terms of yards. How many inches equal a yard is not something subject to daily fluctuations on the free or any other market. The answer is fixed eternally by definition, and what a gold standard entails is a fixed, absolute, unchanging

definition as in the case of any other measure or unit of weight. The market necessarily exchanges two different commodities rather than one commodity for itself. To call for a free market in the price of gold would, in short, be as absurd as calling for a fluctuating market price for dollars in terms of cents. How many cents constitute a dollar is no more subject to daily fluctuation and uncertainty than inches in terms of yards. On the contrary, a truly free market in money will exist only when the dollar is once again strictly defined and therefore redeemable in terms of weights of gold. After that, gold will be exchangeable, at freely fluctuating prices, for the weights of all other goods and services on the market.

In short, the very description of a gold standard as "fixing the price of gold" is a grave misinterpretation. In a gold standard, the "price of gold" is not unaccountably fixed by government intervention. Rather, the "dollar," for the past half-century a mere paper ticket issued by the government, will become defined once again as a unit of weight of gold.

Defining the Dollar

If, then, the dollar should once again be defined as a unit of weight of gold, what should the new definition be? It is curious that the growing number of economists and writers who call for a return to the gold standard seem to display little or no interest in what precisely the new weight of the dollar should be. The question is admittedly a controversial one, but even more controversial is the very question of having a gold standard at all. Moreover, it should be realized that there is no hope of ever returning to a gold standard unless the proper weight of the dollar is first decided upon.

From the 1940s to the 1960s, the small body of advocates of a return to gold were grouped in two kindred organizations: the Economists' National Committee for Monetary Policy, and the Gold Standard League. Both were guided by Walter E. Spahr, professor of economics at New York University. In this era, and indeed from 1933 until 1971, the United States was on a fiat standard domestically, but on a curious and highly restricted form of gold standard internationally, in which the United States agreed to redeem dollars held by foreign governments and their central banks in gold at the legally defined rate of \$35 per ounce. Foreign individuals or private firms could not redeem their dollar balances in gold, and neither individuals nor governments could redeem their dollars in gold coin, since such coin was no longer being issued. Instead, dollars could only be redeemed in large gold bars. However, until 1968 the U.S. Treasury stood ready to maintain the official dollar/gold rate in the free gold market of London and Zurich by purchasing dollars with gold should the gold price threaten to rise above \$35. In that way the United States informally maintained a redeemable dollar at \$35 an ounce for foreign individuals and firms as well as officially for governments and central banks. As European pressure for redemption assaulted the inflated dollar, however, the United States, in 1968, sealed off the dollar from the free gold market, establishing the short-lived "two-tier" gold market. In 1971 the last vestige of international gold redemption was ended by President Nixon, and the dollar became totally fiat.

The Spahr organizations advocated a return to the classic, pre-1933, gold coin standard, with gold coin circulating as the standard money. But they sidestepped the problem of considering the proper dollar weight by simply urging the definition of the gold dollar at 1/35 a gold ounce. Their major argument was that 35 dollars to the ounce was the existing legal definition, and that this definition was effectively the redemption rate for foreign governments and central banks. (They

might have added, as we have seen, that \$35 was also the effective redemption rate for foreign individuals.)

The sole basis of the Spahr call for \$35 was that definitions, once selected, must stand forevermore. But this stance was a weak one, considering that there was no gold standard domestically, and no gold coin redemption at all. Why stand courageously for cleaving to a gold standard at \$35 an ounce, when nothing like a genuine gold standard has existed since 1933? Indeed, if the Spahr group had been consistent in wanting to maintain the old definition of the dollar, it would have urged a return to the last definition under a true gold standard, the pre-Rooseveltian \$20 to the ounce.

The fact that none of the Spahr group so much as contemplated a return to \$20 hinted at a growing realization that \$35 and, a fortiori, \$20, was no longer a viable weight, considering the inflation of money and prices that had proceeded steadily since the advent of World War II. The "classic" gold standard before 1933 was marked by a pyramiding of dollar claims upon a much smaller gold stock (specifically bank deposits upon bank notes and in turn upon gold). During and after World War II, the inflationary pyramiding directed by the Federal Reserve became ever more top-heavy, and a return to a \$35-an-ounce dollar would have risked a massive deflationary contraction of money. For that reason, such dissident members of the Economists' National Committee as Henry Hazlitt, and other economists such as Michael Angelo Heilperin, Jacques Rueff, and Ludwig von Mises, began calling for return to gold at a "price" much higher than \$35.¹⁴

At any rate, at the present time, even the weak argument for a definition of the dollar at \$35 no longer exists. There is no gold standard left in any sense, and the existing "definition" of the value of gold as being \$42.22 an ounce is clearly only an accounting fiction, and at radical variance from its value on the gold market. In a return to the gold standard, we would begin *de novo*, and with a clear slate. In that case, we must realize that there is no moral obligation involved in framing an *initial* definition, and that a new definition of the dollar should therefore be set at whatever figure is pragmatically the most useful. What definition we choose for the new gold dollar is then dependent on what sort of monetary system we would like to achieve, as well as on what definition would assure the easiest transition to that desired system.

Which Gold Standard?

Which definition we choose, then, depends on what kind of gold standard we would like to attain. At the very least, it must be a genuine gold standard, that is, the dollar must be tied to gold permanently at a fixed weight, and must be redeemable in gold coin at that weight. That rules out all forms of pseudo gold standards such as the 1933-1971 monetary system of the United States, or its subset, the Bretton Woods system of 1945-1971. It rules out, similarly, the pseudo gold standard advocated by the supply-side economists, who would go back to something like Bretton Woods.

¹⁴ These dissidents were virtually all in the Austrian tradition, and the three names in the text were all either students or followers of Ludwig von Mises.

In the light of later developments in the gold market, it is amusing to note that the Rueff-Hazlitt proposals for a gold dollar at \$70 were scorned by virtually all economists as absurdly high, and that before 1968, monetarists and Keynesians alike were unanimous in predicting that if ever the dollar were cut loose from gold, the gold price would fall precipitately to its nonmonetary level, then estimated at approximately \$9 per ounce. It is equally amusing to consider that most of these economists would still subscribe to the motto that "science is prediction."

There would then be no gold coin redemption, and, even worse than Bretton Woods, which at least kept a fixed dollar weight in gold, the Federal Reserve would be able to manipulate the dollar definition at will, in attempting to fine tune the economy to achieve such macroeconomic goals as full employment or price level stability.

We could in fact return to the classical gold standard such as all major nations were on before World War I and the United States from the 1850s to 1933. The major advantages would be a return to fixity of weight and to genuine redeemability in gold coin. A classical gold standard would be infinitely superior to either the current or the Bretton Woods system. In this case the particular definition chosen would not matter very much, except that it should be much higher than \$35 so as not to tempt an unnecessary and massive deflationary contraction that would, at the very least, turn public opinion away from the gold standard for decades to come. More important, the classical gold standard would return to the very same system that created boom-and-bust cycles and brought us 1929 and at least the first four years of the Great Depression. It would, in short, retain the Federal Reserve System, and its system of cartelized banking, special privilege, and virtually inevitable generation of inflation and contraction. Finally, while the ultimate monetary commodity, gold, would be supplied by the free market, the dollar would not be truly denationalized, and it would still be a creature of the federal government.

We can do much better, and there seems little point in going to the trouble of advocating and working for fundamental reform while neglecting to hold up the standard of the best we can achieve. If in our disillusionment with central banking, we call for abolition of the Federal Reserve and a return to some form of free banking, what route could we then take toward that goal? The closest approximation to a free banking-and-gold standard was the American economy from the 1840s to the Civil War, in which there was no form of central banking, and each bank had to redeem its notes and deposits promptly in gold. But in working toward such a system, we must realize that we now have a gold supply nationalized in the coffers of the Federal Reserve. Abolition of the Federal Reserve would mean that its gold supply now kept in Treasury depositories would have to be disgorged and returned to private hands. But this gives us the clue to the proper definition of a gold dollar. For in order to liquidate the Federal Reserve and remove the gold from its vaults, and at the same time tie gold to the dollar, the Federal Reserve's gold must be revalued and redefined so as to be able to exchange it, one for one, for dollar claims on gold. The Federal Reserve's gold must be valued at *some* level, and it is surely absurd to cleave to the fictitious \$42.22 when another definition at a much lower weight would enable the one-for-one liquidation of the Federal Reserve's liabilities as well as transferring its gold from governmental to private hands.

Let us take a specific example. At the end of December 1981, Federal Reserve liabilities totaled approximately \$179 billion (\$132 billion in Federal Reserve notes plus \$47 billion in deposits due to the commercial banks). The Federal Reserve owned a gold stock of 265.3 million ounces. Valued at the artificial \$42.22 an ounce, this yielded a dollar value to the Federal Reserve's gold stock of \$11.2 billion. But what if the dollar were defined so that the Federal Reserve's gold stock equaled, dollar for dollar, its total liabilities—that is, \$179 billion? In that case, gold would be defined as equal to \$676 an ounce, or, more accurately, the dollar would be newly defined as equal to, and redeemable in 1/676 gold ounce. At that new weight, Federal Reserve notes would then be promptly redeemed, one for one, in gold coin, and Federal Reserve demand deposits would be redeemed in gold to the various commercial banks. The gold would then constitute those banks'

reserves for their demand deposits. The abolition of Federal Reserve notes need not, of course, mean the end of all paper currency; for banks, as before the Civil War, could then be allowed to print bank notes as well as issue demand deposits.

This plan, essentially the one advocated by Congressman Ron Paul (R.-Texas), would return us speedily to something akin to the best monetary system in U.S. history, the system from the abolition of the Second Bank of the United States and the pet banks, to the advent of the Civil War. Inflation and business cycles would be greatly muted, if not eliminated altogether. Add the abolition of the Federal Deposit Insurance Corporation, the requirement of instant payment of demand liabilities on pain of insolvency, and the long overdue legalization of interstate branch banking, and we would have a system of free banking such as advocated by many writers and economists.

We could, however, go even one step further. If we were interested in going on to 100 percent reserve banking, eliminating virtually all inflation and all bank contraction forevermore, we might require 100 percent banking as part of a general legal prohibition against fraud. The substantial 100 percent gold reserve tradition (held by writers and economists ranging from David Hume, Thomas Jefferson, and John Adams, and partly to Ludwig von Mises), considers the issuing of demand liabilities greater than reserves as equivalent to a warehouse issuing and speculating in warehouse receipts for nonexisting deposits. In short, a fraudulent violation of bailment.

How might the United States go over to a 100 percent gold system? At the end of December 1981, total demand liabilities issued by the entire commercial banking system (that is, M-1), equaled \$445 billion (including Federal Reserve notes and demand, or rather checkable, deposits). To go over immediately to 100 percent gold, the dollar would be newly defined at 1/1,696 gold ounce. Total gold stock at the Federal Reserve would then be valued at \$445 billion, and the gold could be transferred to the individual holders of Federal Reserve notes as well as to the banks, the banks' assets now equaling and balancing their total demand deposits outstanding. They would then be automatically on a 100 percent gold system.

From the standpoint of the free market, there is admittedly a problem with this transition to 100 percent gold. For the Federal Reserve's gold would be transferred to the commercial banks up to the value of their demand deposits by the Federal Reserve's granting a free gift of capital to the banks by that amount. Thus, overall, commercial banks, at the end of December 1981, had demand deposits of \$317 billion, offset by reserves of \$47 billion. A return to gold at \$1,696 an ounce would have meant that gold transferred to the banks in exchange for their reserve at the Federal Reserve would also have increased their reserves from \$47 to \$317 billion, via a writing up of bank capital by \$270 billion. The criticism would be that the banks scarcely deserve such a free gift, deserving instead to take their chances like all other firms on the free market. The rebuttal argument, however, would stress that, if a 100 percent gold requirement were now imposed on the banks, their free gift would do no more than insure the banking system against a potential holocaust of deflation, contraction, and bankruptcies.¹⁵

¹⁵ On the paths to a genuine gold standard, see Murray N. Rothbard, *The Mystery of Banking* (New York: Richardson and Snyder, 1983), pp. 254-69. On the 100 percent gold tradition, see *ibid.*, Rothbard, *Case*, and the neglected work by Mark Skousen, *The 100% Gold Standard: Economics of a Pure Money Commodity* (Washington, D.C.: University Press of America, 1977). Also see Rothbard, "Cold vs. Fluctuating Fiat Exchange Rates," in H.

At any rate, whichever of the last two paths is chosen, money and banking would at last be separated from the state, and new currencies, whether "Hayeks" or "ducats," would be free to compete on the market with the gold dollar. I would not advise anyone, however, to bet their life savings on any of these proposed new currencies getting anywhere in this competitive race.