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THE MORAL ISSUE OF "HONEST MONEY"

Because of the nature of the economics profession—"guild" might be a better word—it is **necessary** to put quotation marks around the words, "honest money." Economists will go to almost any lengths to avoid the use of moral terms when they discuss economic issues. This has been true since the seventeenth century, when early mercantilistic pamphlet writers tried to avoid religious controversy by creating the illusion of moral and religious neutrality in their writings. This, they falsely imagined, could lead to universal agreement, or at least more readily debatable disagreements, since "scientific" arguments are open to rational investigation. The history of both modern science and modern economics since the seventeenth century has demonstrated how thoroughly unreconcilable the scientists are, morality or no morality.

Nevertheless, traditions die hard. Economists are not supposed to inject questions of morality into their analyses. Economics is still supposedly a "positive" science, one concerned strictly with questions of "if then." If the government does A, then B is likely to result. If the government wants to achieve D, then it should adopt policy E. The economist is completely neutral, of course. He is just an observer who deals with means of achieving ends. The economist can therefore deal with "complete neutrality," with this sort of problem: "If the Nazis wish to exterminate 50,000 people, which are the most cost-effective means?" No morality, you understand, just simple economic analysis.

The problem with the theory of neutral economics is that people are not neutral, effects of government policies are not neutral, social systems are not neutral, legal systems are not neutral, and when pressed, even economists are not neutral. Because societies are not neutral, the costs of violating a society's first principles have to be taken into account. But no economist can do any more than guess about such costs. There is no known way to assess the true costs to society of having its political leaders defy fundamental moral principles and adopt any given policy. And if the economists guess wrong—not an unlikely prospect, given the hypothetical moral vacuum in which economists officially operate—then the whole society will pay. (This assumes, of course, that policy-makers listen to economists.)

The inability of economists to make accurate cost-benefit analyses of any and all policy matters is a kind of skeleton in the profession's closet. The problem was debated back in the late 1930's, and a few economists still admit that it is a real theoretical problem, but very few think about it. The fact of the matter is simple. **there is no measuring device for balancing total individual utility vs. total disutility for society as a whole.** You cannot, as a scientist, make interpersonal

comparisons of subjective utility. The better economists know this, but they prefer not to think about it. They want to give advice, but as scientists they cannot say what policy is better for society as a whole.

This is why politicians and policy-makers have to rely on intuition, just as the economists do. There is no scientific standard to tell them whether or not a particular policy should be imposed. Without a concept of morality—that some policy is morally superior to another—the economists' "if then" game will not answer the questions that need to be answered. **Without moral guidelines, there is little hope of guessing correctly concerning the true costs and benefits to society as a whole of any policy.** The economist, as a scientist, is in no better position to make such estimations than anyone else. If anything, he is in a worse position, since his academic training has conditioned him to avoid mixing moral issues and economic analysis. He is not used to dealing with such questions.

What is Honest Money?

Honest money is a social institution that arises from honest dealings among acting individuals. Money is probably best defined as **the most marketable commodity.** I accept a dollar in exchange for goods or services that I supply only because I have reason to suspect that someone else will do the same for me later on. If I begin to suspect that others will refuse to take my dollar in exchange for their goods and services in the future, I will be less willing to take that dollar today. I may ask the buyer to pay me a dollar and a quarter, just to compensate me for my risk in holding that dollar over time.

A currency unit functions as money—a medium of voluntary exchange—only because people expect it to do so in the future. One reason why they expect a particular currency unit to be acceptable in the future is that it has been acceptable in the past. A monetary unit has to have **historic** value in most instances, if it is to function as money. Occasionally, meaning very rarely, a government can impose a new currency unit on its citizens, and sometimes this works. One good example is the introduction of the new German mark in November of 1923, which was exchanged for the old mark at a trillion to one. But normally the costs are so high in having people rethink and relearn a new currency unit that governments avoid such an imposition.

The question policy-makers must ask themselves is this: To avoid the necessity of imposing a totally new currency unit on a population, what can be done to convince people that the future usefulness of the currency in voluntary exchange will remain high? What can be done to improve the historic value of money in the future? In other words, when people in a year or a decade look back at the performance of

their nation's currency unit, will they say to themselves: "This dollar that I'm holding today buys pretty much what it bought back then. I think it's safe for me to continue to accept dollars in exchange for my goods and services, since people trust its buying power. I have no reason to believe that its purchasing power will fall in the future, so I can take the risk of accepting payment in dollars today." If people do not say this to themselves, then the **dollar's** purchasing power is undermined. People will demand more dollars in payment, meaning prices will go up, if they **suspect** that prices will go up. This, in turn, convinces more people that the historic value of their money has been unreliable, which then leads to higher prices.

The economist will tell you that prices cannot continue to go up unless the government, working with the central bank, accommodates price inflation by expanding the currency base. The economist is correct in the long run, whatever the long run is these days, or will be in a few years. **But governments have a pernicious tendency to accommodate price inflation.** Dr. Arthur Burns was forthright about this back in 1976:

These days the Federal Reserve is now and then described as pursuing a restrictive monetary policy. The Federal reserve is described as being engaged in a struggle against inflation. The Federal Reserve is even charged with being more concerned about inflation than about unemployment, which is entirely false. It is by generating inflation, or permitting inflation, that we get unemployment on a massive scale eventually. But let us in the Federal Reserve ask this question: Are we accommodating inflation at the present time or not? The answer—the only honest, professional answer — is that, to a large degree, we are accommodating the inflation; in other words, are making it possible for inflation to continue.

So we get a kind of self-fulfilling prophecy. The government expands the money supply in order to finance its deficits, or create a temporary economic boom, or whatever, and the prices for goods and services rise. Everyone in the "great American auction" has more dollars to use in the bidding process, so prices rise. Then the **public** gets suspicious about the future value of money, because they have seen the loss of purchasing power in the past. They demand higher prices. Then the Federal Reserve System is encouraged by politicians to accommodate the price inflation, in order to keep the boom going (to keep the "auction" lively). The dollar loses its present value, because it has lost its **historic** value, which encourages people to discount sharply its **future** value.

The secret of retaining the public's confidence in any currency unit is simple enough: **convince users of the money that the issuers are responsible, reliable, and trustworthy.** Government and its licensed agents have a monopoly of money creation. Private competitors are called counterfeiters. Sadly, in our day, it is very difficult to understand just what it is that counterfeiters do, economically speaking, that governments are not already doing. **Fiat** money is fiat money. (Perhaps the real legal issue ought to be the illegal use of the government's copyrighted material. Copyright **infringement** makes a much more logical case for Federal prosecution than counterfeiting.)

There is an ancient question that every society must answer: "Who guards the guardians?" Or in more contemporary usage, "Who referees the referees?" The public needs **an impersonal guardian** to restrain the actions of those who hold a legal monopoly of money creation: the government, the central bank, and the commercial banks. The public can guard the guardians if citizens have the right to go down to the local bank and receive payment in gold, silver, or some other

money metal. The issuers of money need only stamp on me paper money (or check, or deposit book entry) that the holder of the currency unit has a legal right to redeem his **warehouse receipt** for a stated weight and fineness of a specific metal. Whenever the issuing agencies begin to issue more receipts than they have reserves of metal, the public has the option of "calling the bluff" of the issuers, and demanding payment, as promised by law. It is this restraint — implicit economically, but explicit legally— which serves as the impersonal guardian of the public trust.

The government can always change the law. Governments do this all the time. Whenever there is a major war, for example, governments suspend specie payments. They also suspend civil liberties, and for the same reason: to increase the power of the state at the expense of the citizens. Governments in peacetime are frequently unwilling to re-establish pre-war taxes, pre-war civil liberties, and pre-war convertibility of currencies, even after the war is over. Civil libertarians have not generally understood **the case for a gold standard as a case for civil liberties**, despite the obvious historical correlation between wartime suspension of civil liberties and wartime suspension of specie payments.

When the authorities declare the **convertibility** of paper into specie metals "null and void," it sends the public a message. "Attention! This is your government speaking. We are no longer willing to subject ourselves to your continual interference in our governmental affairs. We no longer can tolerate illegitimate restrictions on our efforts to guard the public welfare, especially from the public. Therefore, we are suspending the following civil right: the public's legal right to call our bluff when we guarantee free convertibility of our currency. This should not be interpreted as an Immoral act on the part of the government. Contracts are not moral issues. They are strictly pragmatic. However, we assure you, from the bottom of our collective heart, that we shall never expand the money supply, or allow the historic value of the currency to depreciate. It will be just as if we had a gold standard restraint on our printing presses. However, such restraints are unnecessary, and besides, they are altogether too restraining."

Critics of the gold standard (and this includes virtually all Ph.D.-holding, card-carrying economists) tell us that the value of any currency is dependent on public confidence, not gold. But what the critics refuse to admit is that the existence of **the civil liberty of redeemable money** is an important psychological support of the public's confidence in money. Even when the public does not understand the gold standard's theoretical justification—an impersonal guard of the monopolistic guardians—citizens can exercise their judgment on a daily basis by either demanding payment in gold (or silver, or whatever) or not demanding payment. Like the free market itself, it works whether or not the bulk of the participants understand the theory. What they do understand is self-interest: if there is a profit to be made from **buying** gold at the official rate, and **selling** it into the free market (including foreign markets) at a higher price, then some people will enter the markets as middlemen, "buying low and selling high," until the government realizes that its bluff has been called, and it therefore is forced to reduce the expansion of the money supply.

What is the morality of a gold standard? Simple: it is **the morality of a legal contract**. A government's word is its bond. A government promises to restrain itself in the **creation** of money, in order to assure citizens that the monopoly of money-creation will not be abused by those holding the monopoly grant of power. The **gold standard is very** much like a **constitution**: an impersonal, reliable institution which has as its premier function the counterbalancing of potentially damaging monopolistic power.

"Flexible" Money

Flexible money is a euphemism for the government's ability to increase (but, historically speaking, rarely to decrease) the money supply. The degree of flexibility is determined by the political process, not by the direct response of those affected, namely, individual citizens who would otherwise have the right to demand payment in gold. Flexible money means monetary inflation. Very flexible money means a whole lot of monetary inflation. Monetary inflation means, within 24 months, price inflation.

Civil libertarians instantly recognize the danger of "flexible administrative law," or "flexible censorship: or "flexible enforcement of speed traps." Yet they have great difficulty in recognizing precisely the same kind of evil in "flexible monetary policy." The threat comes from the same institution, the civil government. It comes for the same reasons: the desire of the government to increase its arbitrary exercise of monopolistic power over the citizenry, and to limit public resistance.

The Inflationary implications of "flexible monetary policy" can be seen in a revealing exchange between Arthur Burns and Henry Reuss:

DR. BURNS. Let me say this, if I may: the genius of monetary policy—its great virtue—is that it is flexible. With respect to the growth ranges that we project for the coming year, as I have tried to advise this committee from time to time—and as I keep reminding others, including members of my own Federal Reserve family—our goal at the Federal Reserve is not to make a particular projection come true; our goal is to adjust what we do with a view to achieving a good performance of the economy. If at some future time I should come to this committee and report a wide discrepancy between our projection and what actually happened in the sphere of money and credit, I would not be embarrassed in the slightest. On the contrary, I would feel that the Federal Reserve had done well and I would even anticipate a possible word of praise from this generous committee.

CHAIRMAN REUSS: You would get it, and the word of praise would be even louder and more deeply felt if you came up and said that due to the change in circumstances you were proving once again that you were not locked on automatic pilot and were willing to become more expansive if the circumstances warranted. Either way you would get praise beyond belief.

Praise beyond belief! Who wants anything less? Just take the monetary system off "automatic pilot," and turn it over to those whose *political* favor a return of the Inflation-generated economic boom, once the boom has worn off because the printing presses are not the output of fiat money—flat money being defined as former warehouse receipts for metal, in which even the pretense of a warehouse has been abandoned. *tough-minded pilot.*

Politically, there is a great deal of flexibility in monetary affairs. Few people even pretend to understand monetary affairs, and most of those who do really do not understand the logic of the gold standard. The logic is very simple, very clear, and universally despised.

It is cheaper to print money than it is to dig gold.

Fiat money is indeed more flexible than gold, especially in an upward direction. Fiat money allows the government to spend newly manufactured money into circulation. It allows those who gain early access to the newly created fiat money to go out and buy up scarce economic resources at **yesterday's** prices—prices based on supply and demand condi-

tions that were being bid in terms of yesterday's money supply. But this leads to some important problems:

1. Yesterday's prices will climb upward to adjust for today's money supply.
2. People will begin to have doubts about the stability of tomorrow's prices.
3. Producers and sellers of resources may begin to discount the future purchasing power of **today's** dollar (that is, hike today's prices in anticipation).
4. The government or central bank will be severely tempted to "accommodate" rising prices by expanding the money supply.
5. And the beat goes on.

Paying for the Guards

It is quite true, as Milton Friedman has stated so graphically, that the gold standard is expensive. We dig gold out of the ground in one location, only to bury it in the ground in another location. We cannot do this for free. Wouldn't it be more efficient, meaning less wasteful of scarce economic resources, Dr. Friedman asks, just to forget about digging up gold? Why not keep the government or the central bank from expanding the money supply? Then the same ends could be accomplished so much less wastefully. Save resources: trust politicians.

This is a very strange argument, coming as it does from a man who understands the efficiency of market processes, as compared to political and bureaucratic processes. The gold standard is the way that individual citizens, acting to increase their own personal advantage, can profit from any monetary inflation on the part of the monetary authorities. They can "buy low and sell high" simply by going down and exchanging paper money at the undervalued, official exchange rate, and hoarding it in expectation of a higher price, or selling it into the free market at a higher price. Why is the price higher? Because individuals expect the government to go back on its promise, **raise** the official price of gold (that is, devalue the currency unit), or close the gold window altogether. Citizens can become future-predicting, **risk-bearing**, uncertainty-bearing speculators in a very restricted market, namely, **the market for government promises**. It allows those who are skeptical about the trustworthiness of government promises to take a profit-seeking position in the market. It allows those who trust the government to deposit money at 6% or 10% or whatever. Each side can speculate concerning the trustworthiness of government promises concerning redeemability of the currency, or more to the point, government promises concerning the future stability of the currency unit's purchasing power.

Defenders of the commodity futures markets—and this includes Dr. Friedman—argue that the existence of a market for future delivery and future payment of commodities smooths out market prices, since it opens the market to those who are willing to bear the uncertainties of predicting the future. Those who are successful predictors increase their profits, and therefore increase their strength in establishing market prices according to the true future conditions of supply and demand. Those who are less successful soon are forced out of the futures markets, thereby passing along capital to those who are more successful predictors. The public is served well by such markets, for obvious reasons. Prices adjust to future consumer demand more rapidly, since accurate future-predictors are being rewarded in these markets.

Then why not a market for future government promises? Why not a market which can test the government's willingness to deliver a stated quantity and fineness of gold or silver (but preferably gold, given international exchange)? The monopolists who control the money supply then are faced

with a market **which** offers rewards to those who are willing and able to "call the monopolists' bluff" and demand gold for the government's warehouse receipts.

Why not just rely on the standard commodity contracts for gold in the commodity futures markets? Won't skeptics be able to take their profits this way? Why bring in the "spurious" issue of a convertible currency? The answer is simple enough: once society has given a monopoly to the government to create money, then the full redeemability of the currency unit is a direct, immediately felt restriction on government power. Of course the free market in commodities allows speculators to take advantage of **monetary** inflation, if their timing is correct. But this does not mean that the public at large will exercise **effective** action to force a political change in present monetary policy. There is no immediate self-interest involved in expending resources in what could prove to be a fruitless, expensive campaign to stop the inflation. But with full redeemability, the average citizen can help to restrain the **inflationary** tendencies of government by being allowed to "take a contract" on the other side of the bureaucrats and the politicians. The average citizen can speculate against the big spenders who want more goodies from government, but lower taxes (at least on themselves). The average citizen "shorts" the government's promise (implicit or explicit) not to debase the currency unit, while the Treasury Department is forced, by law, to "go long" against any and all citizens who **decide** to go short.

In the commodities market, one investor wins, and one investor loses (unless the price stays the same, in which case only the broker wins). By establishing the gold standard—full redeemability of gold on public demand—the government forces the Treasury to risk becoming an immediate, measurable loser. It forces the Treasury's officials to come back to the politicians and announce, "Folks, we have lost the bet. The public has called our bluff. They have drained us of our gold. We can't go on much longer. We have to stop the inflation. We have to convince the public to start trusting the currency, meaning that they should start trusting our competence in securing them a currency with a future. We have to balance the budget. Stop inflating."

An open commodities market in gold is desirable, of course. But it is no substitute for a gold standard, if the state has a monopoly of money creation (along with its licensed subcontractors, the banks). Unless there is full redeemability, the Treasury is not forced by law to "go long" on its promises whenever anyone else wants to "go short." The **Treasury**, meaning the government, can keep on shorting its own promises, despite the response of organized commodities markets, until an expensive and successful political campaign can be launched to stabilize the money supply. As free market analysis tells us, these campaigns are **expensive** to launch because of such factors as information costs, costs of organizing pressure groups, and the lack of an immediate, short-run pay-off to "investors" who contribute money to such a program. Full redeemability allows market forces to work. Self-interested forecasters can speculate in the government promises market. The public never has to be told to vote, or send letters of protest, or do anything. The self-interested speculators—a small but well-capitalized elite—will do the "policing" job for the citizens free of charge. (Well, almost: there are transaction costs.)

So when we are told that it is **inefficient** to dig gold out of the ground, only to deposit it in a vault, we are not being told the whole story. By tying the currency unit to that gold—which is wonderfully **expensive** to mine, as any **monetary brake** should be and must be—the body politic enlists a cadre of professional, self-interested speculators to serve as an **unpaid police force**. This police force polices the trustworthiness of government monetary promises. The public can relax, knowing that a hard core of greedy capitalists is at work for the public interest, monitoring Federal budgets, Federal Reserve policies, and similarly arcane topics. By forcing the Treasury to "go long" in its own **promises market**, the guardians are guarded by the best guards of all: Future-predicting, self-interested speculators whose job it is to **embarrass those who do not honor contracts**—their own contracts.

Conclusions

I suppose I could invest more time in presenting graphs, or faking some impressive looking equations, or citing innumerable forgotten defenders of the gold standard. But I think I have reached the point of diminishing returns. The logic of the gold standard is really fairly simple: **Treasury monopolists, like all other monopolists, cannot be trusted to honor their promises.** Better put, they cannot be trusted at **zero cost**. The gold standard is one relatively inexpensive way to impose high costs on government monetary officials who do not honor their implicit contracts with the body politic to monitor and deliver a reliable currency unit that will have future value—a trustworthy money system. There are **moral** issues involved: honoring contracts, preserving social stability, providing a trustworthy **government**. There are civil **liberties** issues involved: protecting citizens from unwarranted taxation through monetary inflation, protecting citizens from arbitrary (read: "**flexible**") monetary policies, and restricting the expansion of **government** power. There are **economic** issues involved: designing an institutional mechanism that will bring self-interest to bear on **political-economic** policies, stabilizing purchasing power, increasing the spread of information in the community, increasing the political risks of money monopolists. No doubt, I could go on, but these arguments seem sufficient.

The real question is more fundamental: Do we trust governments or the high costs of mining precious metals? William McChesney Martin, Dr. Burns' predecessor as Chairman of the Federal Reserve Board, gave us the options back in 1968, in the midst of an international monetary crisis:

It's governments that you have to rely on. Basically, you can't rely on a metal for solvency.

Those of us who cannot bring ourselves to trust the government with the monopoly over the control of money prefer to trust a metal. It may not be the best thing to trust, but it is **certainly** more reliable than governments.

The case for a gold standard is the case against **arbitrary** civil government. While politicians may well resent "automatic pilots" in the sphere of monetary policy, if we had a more automatic pilot, we should have less intensive "boom-bust" cycles. When the "automatic pilot" is subject to tinkering by politicians or Federal Reserve officials, then it is not automatic any longer.

The appeal of specie metals is not the lure of magical talismans, as some critics of gold seem to imply. Gold is not a barbarous relic. Gold is a metal which, over millennia, has become acceptable as a means of payment in a highly complex institutional arrangement: the monetary system. Gold is part of **civilization's** most important economic institution, the **division-of-labor-based** monetary system. Without this division of labor, which monetary calculation has made possible, most of the world's population would be dead within a year, and probably within a few weeks. The alternative to the free market social order is government tyranny, some military-based centralized allocation system. Any attempt by the state to alter men's voluntary decisions in the area of exchange, including their choice of exchange units, represents the true relic of barbarism, namely, the **use of force** to determine the outcome of men's decisions.

The gold standard offers men an alternative to the fiat money systems that have transferred massive monopolistic power to the civil government. The gold standard is not to be understood as a restraint on men's freedom, but just the opposite: a means of restraining that great enemy of freedom, the **arbitrary** state. A gold standard restores an element of impersonal predictability to voluntary **exchange**—impersonal in the limited sense of not being subject to the whims of any individual or group. This predictability helps to reduce the uncertainties of life, and therefore helps to reduce the costs of human action. It is not a zero-cost institution, but it has proven itself as an important means of reducing arbitrary government. It is an "automatic pilot" which the high-flying, loud-crashing political daredevils resent. That, it seems to me, is a vote in its favor.