The Gold Standard in Contemporary Economic Principles Textbooks: A Survey

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Throughout much of modern history, gold served as the commodity that most widely facilitated free exchange.[1] While its virtues as a medium-of-exchange were clear to people of previous eras, gold has fallen out of favor, both in its use as money and in the esteem in which it was once held among academics. It used to be the case that gold, the gold standard, and the various other iterations it took over its many years of employment saturated the study of money and economics, but now it is often difficult even to find substantive references to it in modern textbooks. Just what is the prevailing understanding today on the subject of the gold standard? The world is now a generation removed from any semblance of a gold standard and well over a century from its heyday. With little or no practical experience with it, almost all dialogue about it exists now in the fringes of the academic community. The minimal emphasis that mainstream economists place on a gold standard is reflected in the scant attention placed on it in modern principles of economics and monetary textbooks.

Presented here is a survey of 65 modern post-WWII undergraduate economics textbooks on how they address the subject of the gold standard, looking at the level of information provided, the quality and organization of their argumentation on the topic, and any underlying bias that might be reflected in their treatment of the gold standard.[2] Then turning to the Austrian economic

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[1]Silver and other precious metals and commodities have also often served as common media-of-exchange, however, not nearly to the extent that gold did.

[2]The 65 texts were selected from the Auburn University Library. Auburn University had a Ph.D. program in economics until 1999. They still have a Ph.D. program in applied economics in their Agricultural Economics department. This survey is based on the assumption that this is a representative sample of what would be found in other contemporary U.S. research universities. All the texts were undergraduate level general economics or money and banking textbooks. In most cases, the most recent edition available of

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literature, a brief critique of the relevant issues is conducted and considerations concerning sound money and a gold standard.

Modern Economics Textbooks on the Subject of Gold

Austrian economists have always been quite reserved in their praise of textbooks, arguing that they often fail to present the study of economics as one integrated and cogent system, rather, presenting different topics and concepts in isolation of each other. In one review of a popular textbook, Murray Rothbard criticized it as a "swollen and elephantine grab-bag" of current economic thought (Rothbard 1973). It should then be of little surprise to most readers familiar with the Austrian School that the problems plaguing textbooks as a whole should manifest themselves when it comes to how these books present the topic under discussion. The concepts of gold as money and the gold standard are not uniformly handled in every textbook. It is rare to find a clearly marked and systematically argued presentation of the issues surrounding it in modern textbooks. A greater majority of them, particularly those from the 1980s to the present day, do not even present this topic under a dedicated subheading, but tend only to pepper a few paragraphs with tidbits and opinionated statements on gold amidst broader discussions of what they would deem to be more "relevant" topics. A few of the most modern textbooks scarcely address gold in their main body texts, reserving discussion of it to inset textboxes or the margins with all the other relics of economics science that are now considered to be of only trivial importance.

Finding references to the gold standard can often be difficult. Nearly a quarter of all the textbooks reviewed did not even list any terms related to this precious metal in their indexes. No textbook had a unique chapter assigned to gold. The most frequent references to it were found in chapters dealing with the creation of money, banking, the Federal Reserve System, international trade, and international monetary systems. Within these chapters, the variety of information provided was diverse, with few standardized methods of presenting the topics from one textbook to the next. While there were a few conventions that appeared with high regularity, like the use of the story of enterprising goldsmiths to explain the development of fractional reserve banking, even the presentation of these stories varied considerably. While a majority of texts presented the goldsmith story as a true historical account of the development of banking, others denounced it as "apocryphal"[3] and mere myth.

The amount of information provided is also considerably small. The average textbook from 1950 to 1980 reserved between ten and fifteen combined

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the textbook was used. In the few cases where there was a large time gap between early and later editions, the earliest and latest editions available were examined in tandem. In almost all of these cases, no relevant or significant changes were made to how they approached the subject of our examination.

[3]See, for example, Colander (1995, p. 313).

pages for subjects related to gold, while the average textbook from 1980 to present, only about three or four combined pages.[4] It is also interesting to note that the average length of textbooks from the earlier period was around 600 pages while the textbooks from the more recent period averaged over 800 pages. The easiest way to explain the discrepancy in time spent on the gold standard between the two periods of texts is that the earlier books usually emphasized a clear presentation of the mechanics behind the gold standard when it came to international trade and the Bretton-Woods system. The newer textbooks usually reserved that space for what they saw as the more relevant issues of international trade and somehow managed to explain how the standard functioned for over a century in a paragraph or two.

Aside from a few pleasant and welcome instances, nearly all the texts, without regard to period, failed to adequately differentiate between the diverse incarnations of the gold standard. These texts often conflate the core components of all the different systems into one, allowing a few authors to construct a convenient "straw man" gold standard that would rarely withstand the tailored arguments thrown against it and be easily dismissed as a "barbarous relic"[5] whose fate was assured by the inescapable progress of civilization. Not a single author of any of the texts reviewed presented any ideas for shifts in the current monetary system toward a gold-based system positively. Roughly one-third of the authors offered systematic arguments for and against such a standard and expressed relatively positive statements about its effectiveness while in use. The other two-thirds of the authors presented the topic in a non-systematic method and made pronouncements against it ranging from historical and theoretical arguments to simple snide and dismissive statements.

The next several sections here will investigate these findings further as they relate to how the texts address gold and the gold standard in relation to the creation of money, the mechanics of the gold standard, inflation and price stabilization, theoretical and historical argumentation, and money and banking issues. Since few authors attempted to approach this topic using clear systematic argumentation, there may be some inevitable overlap within these categories. It is also, in many instances, interesting to note the trends and significant differences between texts of differing time periods, and this paper addresses those when they were deemed sufficiently consistent or relevant.

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[4]One important consideration, which this paper does not address, is how textbooks present alternative monetary systems. Since these systems ideologically compete directly against the gold standard, this would be a very relevant area for further study. Many authors, who largely ignore the gold standard and fail to clearly present the arguments for it, are strong advocates for other systems and the only real way to decipher their ideological bent, would be to see what issues they raise when comparing the various more recent and mainstream suggestions for monetary reform.

[5]A famous quotation by John Maynard Keynes. Quoted here from the introductory sentiments in Ise (1950, p. 327).

Gold as Historical Money

Most textbooks first introduce the concept of gold in a section on the creation and development of money. This section tends to be about one-quarter the way into most texts and is usually either a separate chapter or an introductory section in the chapter on money and banking.[6] The basic fundamentals of exchange and market transactions have typically already been discussed. The typical section on the creation of money is between five and ten pages in length, of which the discussion of gold can run anywhere from a solitary mention of it in a long list of other common goods that have been used as a medium-of-exchange to a multi-page discussion. The most typical setup, especially in the more recent textbooks, rarely spends more than a paragraph talking about gold in this section. However, it is important to look at how it is presented.

Earlier period texts rarely editorialized in their discussion of the origins of money while most modern authors frequently used critical language whenever referencing anything having to do with gold. One text describes the varieties of commodity monies in this manner, "Primitive economies have used everything from precious metals and polished rocks to strings of seashells, wives, and slaves" (Reynolds 1966, p. 20). Many authors continually referred to gold as "primitive" or being indelibly linked to "less organized societies."[7]

Most modern texts spent far more time on obscure instances of commodities developing into money than the development of gold. The most common commodities were the Stone of the Island of Yap[8] and cigarettes in concentration camps during the World Wars. Particularly in modern texts, these examples frequently constituted the bulk of their discussion, with gold receiving only scant mention.[9] One text focused almost exclusively on the use of cows as money, pointing out the etymology of terms such as *pecuniary* and comparing a cow-based monetary system to our gold-based system, resulting in one of the odder discussions encountered,

> just as some people of an earlier period probably continued to think that gold and silver served as money only because they were "backed" by cows, so some people continued for years to believe that demand deposits and bank notes were not "real" money, but only valuable because they were "backed" by gold. (Suits 1973, p. 249)

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[6]Though in a few books, the properties of money are not discussed until the very end. See, for example, Stiglitz (1993, pp. 870–86).

[7]See, for example, Baumol (1994, p. 718).

[8]Famed large stones of lime that were rarely moved when they changed ownership on this primitive island community.

[9]See, for example, O'Sullivan (1998, p. 553) and Ekelund (2000, p. 653).

Another author used a similar, but hypothetical, example of a corn-based economy to walk the reader through this lengthy section, using corn to demonstrate inflation and Gresham's law, without clearly enlightening the audience that these concepts originally and most closely apply to a discussion of metallic currency (McEachern 2003, p. 654).

The most common explanation provided for gold losing its popularity as a money was the inconveniences of transporting and measuring units of it. This naturally led to issuance of paper certificates, with most authors usually ignoring the role governments played in this process, including the introduction of legal tender laws and providing legal protection to banks.[10] These sections rarely used any form of adequate historical dating. According to these texts, gold was used, like all the other commodity monies, in the past and fiat currencies in the present. Paul Samuelson (1980, p. 263) cautioned the "modern student" not to be misled, "as were earlier generations of students by some mystical belief" that gold inferred any value to money and then went to the trouble of cataloging all the groups of people who still harbor an eccentric and somewhat malevolent interest in holding gold, including,

> Footloose refugees, underworld interests, tax evaders, opponents of welfare state, . . . those foolishly confident that ultimately gold will be restored to a central place in the official monetary systems of the world, and shrewd and unshrewd speculators, who bet that enough dupes believe the above case. (Samuelson 1980, p. 673)

The Mechanics of the Gold Standard

The space each author devotes to discussing the basic history and the mechanics of how the gold standard functioned under each incarnation varies significantly depending on whether the texts were written during the Bretton-Woods system or after. Logically, the earlier texts present a more thorough analysis of how the balance-of-payment mechanism functioned as well as relevant facts about the world monetary system and the gold exchange standard. The more recent texts do, on the whole, a very poor job presenting the mechanics of the gold standard in any thorough or systematic method; most texts claim it is now only of historical significance.[11] Many do not even precisely define the variant forms and time periods when the gold standard functioned. Some texts suggest it existed from the end of the Napoleonic Wars to the beginning of World War I[12] while others posit it began around the American revolutionary period and lasted till either the great depression or the 1970s. Still others offer no real historical landmarks to guide the reader.[13]

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[10] See, for example, Stiglitz (1993, pp. 870-86).

[11] See, for example, Lipsey (1966, p. 466).

[12] Ibid.

[13] See, for example, Byrns (1989, p. 223).

Judging the whole corpus of economic textbooks, it is virtually impossible to consistently find a thorough explanation of the differences between the classical gold standard, the gold exchange standard, bimetallism, the limited gold bullion standard, and the other relevant modifications actually seen in practice. It follows that all but a few texts completely ignore the many nuances that Austrians place a heavy emphasis on, such as principles of sound money, reserve ratios within the banking system, and the different political motivations and levels of government intervention during these periods.

Many of the more modern authors chose to introduce the explanation of the gold-flow mechanism by repeating simplified arguments of a few classical economists of the eighteenth and nineteenth centuries and then offering their own explanations for how these simplistic and idealistic assumptions rarely played out in the real world. They ignore the fundamental distinctions between a completely market originating gold standard and one that has been partially co-opted or obstructed by government intervention.

Textbooks on Inflation and Price Stabilization

The topic of the gold standard naturally leads to extended discussions on inflation and price stabilization. Here, a considerable amount of confusion results from authors arguing between *what* actually is best for society and *which* monetary systems are most likely to promote the welfare of society. Many of the authors say that proponents of a gold standard, often labeled "staunch conservatives,"[14] are most concerned with stabilizing the price level. None of the texts reviewed made the distinction between the natural variation of prices in a market originating gold standard, with which most Austrians would not have a problem, and the desire of economic planners to use a gold standard to manipulate and maintain some artificial and arbitrary price level, which Austrians tend to oppose. Most authors who addressed this topic conflated all supporters of gold as supporters of price stability and then proceeded to show how the gold standard failed to maintain price stability, and consequently, should be regarded as a failed endeavor.[15] Nevertheless, a number of modern authors mentioned that many proponents of the gold standard see the central issue to be one of reducing or preventing government intervention.[16]

There is also considerable employment of vague and poorly reasoned argumentation as many authors fail to distinguish between historical events, economic realities, and the myriad of unrelated concomitant conditions in existence. In one of the more egregious examples, Bach (1963, p. 240) argues that the gold standard is flawed *because* it did not promote price stability, stating,

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[14]See, for example, Samuelson (1980, p. 263).

[15]See, for example, Arnold (1989, p. 406) and Byrns (1989, p. 155).

[16]Though Samuelson puts it this way: "Staunch conservatives . . . are convinced that governments cannot be trusted to refrain from abusing this power . . . and prefer the vicissitudes of mine discoveries rather than in fallible or allegedly corrupt governments" (1980, p. 263).

> But United States history illustrates clearly that the gold standard is no guarantee against sharp price-level changes. The graphs in chapter 6 show the great inflation that took place during and following World War I, the precipitous drop following that inflation, and the sharp drop from 1929 to 1933, *all while we were firmly on the gold standard.*

Here Bach blames the gold standard for failing to have an effect it was arguably never intended to produce, a stable price level; and further, he fails to take into account the government interventions prior to 1929 in the money supply that nullified all of the stabilizing effects that a gold standard could infer.[17]

When it comes to inflation, most of the discussion relates around two questions, what are the effects of inflation under a gold standard and can the gold standard actually prevent inflation? The first question often opens the door to social planning. Every textbook assumed that some level of government intervention could bring about an increase in social welfare, though their views on the optimal policy varied.[18] One author harshly criticized inflation because the redistribution it brings about "isn't on the basis of income levels, number of dependents, or other socially acceptable economic criteria. Instead, it is haphazard and inequitable in a manner unrelated to society's objectives" (Spencer 1993, p. 146). Another author explained that "a closer look at who benefits and who loses from unanticipated inflation suggests that there are probably more gainers than there are losers" (Stiglitz 1993, p. 968).

It is generally accepted by nearly all the authors surveyed that the world experienced far less inflation while under the gold standard, in their words, often causing a "nostalgia" (Fischer 1983, p. 658) for this bygone era, yet few authors seem to think this is an important or consistent enough attribute to warrant serious reconsideration of the merits of the gold standard.[19] Many

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[17]It is also misleading to blame the classical gold standard when it was abolished by the warring countries in Europe. This caused an influx of gold to America and permitted more monetary inflation than otherwise. Furthermore, the gold exchange standard was abandoned in 1931 by Britain. For a thorough analysis of the monetary issues related to the Great Depression, the most authoritative resource is Rothbard's *America's Great Depression* (1972). While most texts failed to clearly demarcate what the actual supply of money contained at certain times, one text offered this rare definition which goes a long way, compared with other texts, to clarifying what is taking place. "Any reference in this chapter to the gold standard relates to a monetary system based on gold, but containing sizable elements of fiduciary money. If the monetary circulation consisted of nothing but gold coins, no monetary authority would be able to exercise a deliberate impact on the size of M" (Kortewg 1959, p. 77).

[18]Quite a few texts don't offer rigorous defense of social welfare, rather, they briefly present all the different models and seem to assume an argument *ad numerum* that the prevalence of models suggests that a social criterion of some kind must exist.

[19]While many authors agreed that it produced less inflation, this was not universally accepted as a significant positive argument for the gold standard. As Stanley Fischer (1983, p. 659) comments, "The chief advantage [of the gold standard] is the low average rate of inflation that would likely to result . . . but we should not be too influenced by the experiences of the nineteenth century . . . the gold standard was not an infallible bulwark against inflation."

authors mention that the era of the gold standard put the economy into a "strait-jacket" (van Sickle 1954, p. 292) that forced it into considerably higher unemployment and far more price variability than experienced since World War II (Fischer 1983, p. 874). Still, many authors argued that the supposed *golden calf* of the gold standard, price stability, was elusive and furthermore, that the gold standard was no guarantee against inflation. The most commonly cited cause of inflation and price level changes during the classical gold standard was changes in the quantity of mining and new discoveries of gold. Government intervention, typically presented as a necessary step in times of war and crisis was the second most frequently cited cause.[20] Only a few authors added the crucial caveat that during these times, governments habitually suspended the essential operations of the gold standard. However, overall, most authors give the gold standard its due for helping to restrict inflation.

Authors' Arguments and Perspectives on the Gold Standard

Few authors have approached the topic of gold using uniform categories or systematic argumentation. In approximately half of the textbooks, the best method for distilling their perspective on the topic of gold is to glean it from pithy comments and incomplete arguments, almost always derogatory, scattered throughout their books.[21] Chapters on the origins of money, international monetary systems, and money and banking were the likeliest candidates for these brief expositions. In another quarter of the texts, the writers presented a semblance of systematic argumentation, both pro and con, though it was rarely comprehensive and usually sided with the mainstream interpretation.[22] In the final quarter of the material reviewed, the writers presented a simple working version of the classical gold standard and then proceeded to spend as much or more time offering all the arguments against it.[23] Several of these expositions would likely leave an uninitiated student wondering how such a flawed system could ever have been coincidental with such a long period of peace and prosperity.

Another common feature is the considerable use of the passive voice where the actors should have been identified or where the identification of those actors would impugn them. A common example is the statement, "The dollar was devalued" (Lipsey 1984, p. 951), however, it is highly unlikely that this devaluing was due to the Fates colluding against mankind, but rather the necessary effect, whether anticipated or not, of actions, in the specific case mentioned by the author, of the government. Similarly, in another section, Lipsey stated, "In the period after World War I, the gold standard failed and

[20]A more detailed examination of these arguments can be found in the section labeled "The Vicissitudes of Mining" and "The Effects of the Great Depression and the World Wars."

[21]See, for example, McEachern (2003) and O'Sullivan (1998).

[22]See, for example, Arnold (1989) and also van Sickle (1954).

[23]See, for example, Case (1999).

was abandoned" (1984, p. 479) ignoring the relevant question of who was pushing for its abandonment and what their motivations for considering it "failed" might have been.

The next few pages will focus on how the textbooks address or construct arguments proving or disproving the viability of the gold standard, including mining and the supply of gold, hoarding, the domestic vs. international tensions a gold standard creates, the effects of the World War I and the Great Depression, and the role of banking.

The Vicissitudes of Mining

For a disturbingly high number of authors, mining seems to be the linchpin by which the whole gold standard rises and falls. Many authors offered practically no other assault on the viability of the gold standard except that it was subject to these vicissitudes.[24] A slight tinge of contempt can be detected in the tone of many when they talk about gold-exporting countries and the owners of mines, as if the gold standard wrongly endowed these sinister countries and businessmen with unchecked monopoly power over the rest of the world.[25] The argument that the gold standard is inequitable because it benefits the gold-producing nations at the expense of all others for no reason beyond the random endowment of natural resources is used rather frequently. One commentator goes so far as to cite this argument as the primary motivation for President Reagan deciding against returning to the gold standard early in his administration (Case 1999, p. 860).

As a matter of historical fact, the large discoveries of gold in South Africa and the Klondike are often mentioned as clear reasons why the gold standard could not insulate an economy from rapid changes in the money supply. However, aside from simplistic comments of this nature repeated *ad nauseam*, extremely few texts offered any kind of statistical data to show the severities of the fluctuations during these periods and almost all ignored the fact that the actual periods when the gold standard was temporarily abandoned rarely coincided with spikes in the physical supply of gold but rather with sizable changes in the supply of fiduciary media.[26] The language used to explain the effects mining can have is telling. One writer opined that a fundamental problem with the gold standard is that it placed the world's commerce "at the *mercy* of the gold discoveries" (Baumol 1994, p. 915). Another stated, "Discovery of new gold sources or improvements in the technology used to extract gold from existing mines would likely bring about *rapid* inflation" (Ekelund 2000, p. 815). Others frequently used adjectives to describe the potential changes in the money supply including "*chaotic*" and "*tumultuous*."

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[24]See, for example, Ekelund (2000).

[25]The recent antitrust clash with Microsoft comes to mind (Dilorenzo 2001).

[26]As Rothbard (1991, p. 57) argued: "National fractional reserve systems are the real source of most of the difficulties blamed on the gold standard."

Effects of Gold Hoarding

Hoarding was occasionally cited as a serious problem for the stability and functionality of the gold standard. This argument comes down to little more than a complaint that people act differently than the observer or the government thinks they should. "Hoarders" were frequently depersonalized into a sinister alliance of misers that actively try to thwart society's welfare. Having earlier stated that gold's main use throughout history has been hoarding, Samuelson (1984, p. 261) offered the exclusive argument that when FDR outlawed the private ownership of gold, that "this was done so that holders or hoarders of gold could not make a 67 percent profit from the devaluation of the dollar" (p. 263). But as Ludwig von Mises observed in many of his works on money, hoarding merely represents another demand for money and does not affect the demand structure in any unnatural or particularly destructive way.[27] The real problem here for these authors is that these "hoarders" are not acting in a politically expedient manner for those currently in power.[28]

The Interests of Domestic Versus International Affairs

One of the more serious arguments focused on is the concept that the gold standard removes control over the domestic monetary situation from a country's government and often places its domestic policy and international interests at odds. These texts argue that the expansive aggregate monetary policies needed for domestic prosperity—inflation—is precisely opposed by the desire of net exporters to decrease the domestic stock of money to lower prices and give them a competitive edge on the world market.[29] Wonnacott (1990, p. 219) argued,

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[27]Mises (1998, p. 399) states:

> What is called hoarding is a height of cash holding which—according to the personal opinion of an observer—exceeds what is deemed normal and adequate. However, hoarding is cash holding. Hoarded money is still money and it serves in the hoards the same purposes which it serves in cash holdings called normal. He who hoards money believes that some special conditions make it expedient to accumulate a cash holding which exceeds the amount he himself would keep under different conditions, or other people keep, or an economist censuring his action considers appropriate. That he acts in this way influences the configuration of the demand for money in the same way in which every "normal" demand influences it.

[28]Guido Hülsmann (2003, p. 53) clarifies,

> "Hoarding" is a pejorative expression for an increase in the demand for real cash balances. Let us first remind ourselves that quantities of money are "hoarded" because each single money unit is held in the "hoard"—that is, in the cash balance—of some individual. Therefore it is impossible to hold money more intensely than it otherwise would have been held.

[29]See, for example, Wonnacott (1990, p. 343).

> The biggest problem with the gold standard, then, is that it does not provide a steady and measured restraint. Rather, it exerts restraint in the form of a threat of disaster . . . as long as the authorities are lucky, with gold flowing in steadily from mines or from foreign countries, and as long as they follow farsighted policies that prevent any crisis of confidence, it is possible that the system may work reasonably well.

The crucible of this argument is the term "farsighted policies." The complaint here is that the gold standard forces governments to irrationally restrain themselves by not pumping *faux* money into their domestic economies in an attempt to reap short-term political gains. Consequently, this argument is not really one so much against the gold standard as it is in favor of government intervention, which is hindered by the "strait-jacket" that an effective gold standard demands.

Government intervention is subject to the same economic laws that all other actions must report to. That a gold standard is flawed because it holds a government responsible for the necessary effects of its actions is not an economic argument but a political one. Any time a change in market conditions takes place, adjustments will be made. Economic laws cannot be avoided and attempts to do so are misguided. The argument that the gold standard forces nations to "accept domestic adjustments in such distasteful forms as deflation, unemployment, and falling incomes, on the one hand, or inflation, on the other" (McConnell 1972, p. 757) is a Catch 22. Regardless of the monetary system, changes in the supply of money will result in either inflation or deflation; there is no other option. One cannot escape fundamental economic realities. What it appears this author is really interested in is finding a monetary system whose relative elasticity allows a nation to avoid culpability for its actions for the longest possible interlude.

The Effects of the First World War and the Great Depression

A few authors clearly state that the real reason the gold standard was abandoned during the depression of the 1930s was that it limited the government's ability to inflate the money supply[30]—though even this limitation is not universally seen as positive. Many, however, do not present the situation quite so clearly. Most notably, numerous texts claim that this period was really the first time people began seriously considering that the gold standard may not, in fact, provide the optimal quantity of money for the new emerging brand of growing, full-employment economies. As authors van Sickle and Rogge noted in 1954,

> The revolt against the gold standard is an outgrowth of the Great Depression of the 1930s and of the experience of World War I when national economies, divorced from gold and stimulated by enormous government spending, were able to provide continuous employment for all able and

[30]See, for example, Gitlow (1962, p. 654).

> willing workers. These two experiences also led to a revolt against the traditional view that market forces tend to keep a competitive private enterprise economy operating at the full employment level. (van Sickle 1954, p. 364)

While most authors, who claim that the Great Depression was the "straw that broke the back of the gold standard" (Arnold 1989, p. 806), recognize and point out that this was caused by the monetary expansion during the World War I, few place the key emphasis on the link between these two phenomena. Paul Wonnacott, responding to serious considerations in 1979–80 of returning to the gold standard, (without addressing possible government action that may have caused in the first place the adverse effects so often blamed on the gold standard) states that the present attempt to return to it "would be a mistake. The gold standard contributed to the depression of the 1930s; it can make the economy unstable" (Wonnacott 1990, p. 220). Similarly, Bach (1963, p. 240) states that the changes in the money supply during this period occurred while we were "*firmly* on the gold standard." The clearly intended inference for the reader to make is that the gold standard *was* the contingent cause of the changes in the money supply. Fortunately, most authors aren't as blatant as Bach, but still fail to appropriately disaggregate the conditions present during that period. They end up either intentionally or unintentionally blaming the gold standard for many of the problems of that era.

Few texts offered any systematic discussion of the monetary actions that were undertaken by the belligerents in World War I, even fewer pointed to the creation of the Federal Reserve in 1913 as a key event in allowing the United States to adopt inflationary policies. Many authors simply stated the position that the War caused the participating countries to abandon the gold standard in order to "safeguard their metallic reserves."[31] They rarely explained why such reserves would need to be safeguarded, namely that these countries were heavily inflating their money supplies to fund wartime efforts. No textbook extensively analyzed the monetary changes throughout the period from World War I to the Great Depression and the worldwide abandonment of the gold standard.

The Role of Banking and Fractional Reserve Practices

Gold has played an important role in influencing the development of money and consequently, banking. Most writers acknowledge the unique historical role gold once played. While the topic of banking is usually initially introduced as dealing directly with gold, these discussions tend to quickly shift to the modern and more useful machinations of the monetary establishment, namely fiat paper currencies. Approximately two-thirds of the texts reviewed introduce the concept of banking with the goldsmith story.[32] There

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[31]See, for example, Fairchild (1954, p. 257).

[32]See, for example, Spencer (1993) and also Fischer (1983).

is some variability on whether the authors posit this as the authoritative historical development of banking or simply a useful allegory.

Most texts began explaining, albeit briefly, that gold, being cumbersome for actual exchange in most transactions, was increasingly left in warehouses while the receipts for redemption of the gold became frequently used in its stead. Some portrayed these goldsmiths as "enterprising"[33] while others portray them as absent-minded shopkeepers who one day happened to "observe"[34] that the physical stock of gold did not vary much from day to day and month to month. In either case, they came to realize that they could print up a small amount of extra receipts for the gold in their warehouses and either spend it themselves or lend it out with interest without substantially effecting their solvency. This realization birthed fractional reserve banking.[35]

At this point, having just explained that *true* banking began when someone first issued claims on gold that actually belonged to someone else, a few authors felt it necessary to warn any uninitiated readers against considering the practice of fractional reserve banking as dishonest.[36] However, just when one might expect an exposition on its morality or a clarification of what really takes place, the best we get is an *argumentum ad populum* of sorts, appealing to fractional reserve banking's widespread use as sufficient authority to allay any concerns of ethics. From this point on, nearly all texts assume fractional reserve banking as standard practice[37] and only a few even acknowledged that there are people who are opposed to such an institutional arrangement on ethical or practical grounds.[38] None of the material under review ever mentioned or referenced any concept of property rights in this regard.

Invariably, during the discussion of the creation and evolution of modern banking, the topic of bank runs comes up. While there is some variety on how this topic is covered, the vast majority of the texts present the problem as being now one of only historical interest because the present central banking

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[33]See, for example, Baumol (1994, p. 722).

[34]See, for example, Byrns (1989, p. 227) and also Colander (1995, p. 313).

[35]Most texts saw deposit creation as being at the heart of the role of banking. See, for example, Gill (1978, p. 248).

[36]See, for example, Case (1999, p. 616).

[37]The following quotation typifies how many authors explain, if they explain at all, the present contentment with such an arrangement.

> Our current monetary system has evolved over hundreds of years during which commodity money was first replaced by full-bodied paper money . . . finally we arrived at our present system. . . . Like a hesitant swimmer who first dips her toes, then her legs, then her whole body into a cold swimming pool, we have "tested the water" at each step of the way—and found it to our liking. It is unlikely that we will ever take a step back in the other direction. (Baumol 1999, p. 719)

[38]See, for example, Bach (1963, p. 223).

system has ended any concern over irredeemably. However, historically, quite a few texts present the fear of irredeemability as being even then somewhat irrational. The claim is that the only thing that the people *really* should fear is fear of bank runs itself. Instead they should see bank runs as unfortunate in that they often arbitrarily interrupted periods of great prosperity and expansion. Many authors resorted to chiding bankers of old for not being shrewd enough while acknowledging that the real solution would later be found in institutional change.

Government Intervention into Banking and the Management of Money

Why did governments get involved in market produced banking?[39] Explanations range from the danger of having "profit-oriented bankers [who] might otherwise provide the economy with a gyrating money supply that dances to the tune of the business cycle" (Baumol 1994, p. 735), to the vast benefit a centrally managed money supply can provide in promoting a growing, full-employment economy.

While every text incorporates a thorough explanation of how the Federal Reserve functions, many authors sympathize with a sort of rational ignorance on the part of the readers and the general public concerning the complicated affair of money creation. Paul Samuelson comments, "The public neither knows nor cares—and need not know or care—whether its currency is in the form of silver certificates, Federal Reserve notes, or copper or silver coin. So long as each form of money can be converted into any other at fixed terms, the best is as good as the worst" (Samuelson 1980, p. 261).

With the presence of the Federal Reserve system firmly established, this literature turns its attention to various issues of managing the money supply. The level of reserves, particularly under the Bretton-Woods system, is a frequently occurring topic. Some authors express bewilderment at the government's stubborn policy of maintaining high reserves, particularly during the earlier half of the twentieth century. One compared this scenario to the fable of King Midas who would later discover that he could not eat his gold.[40] Other authors expressed frustration at the disutility and high costs of mining gold

[39]All the textbooks did an appallingly poor job of tracing the historical development of this institution. They left out the effects of legal tender laws and other government interventions necessary to institutionalize a fundamentally bankrupt practice. Furthermore, they rarely even mentioned, let alone explored the concept of free banking and how it is relevant for today.

[40]George Leland Bach (1963, p. 241) stated:

> During the 1930s we got nearly $20 billion of gold from abroad, giving foreigners in exchange goods, services, and investments in American industries and government bonds. Then we carefully buried the gold in Fort Knox and paid soldiers to guard it. The fable of King Midas, who finally found he could not eat his gold, looked uncomfortably close to many observers.

only for it to be reburied in Fort Knox.[41] For them, this irrational fascination with gold "was the center of a 'religion' of money" (Bach 1963, p. 660).

The other reoccurring problem that mismanagement of the money supply can bring about is inflation. While all texts acknowledged the higher levels of inflation compared to previous eras, few offered a side-by-side comparison of inflation under the gold standard versus the Federal Reserve system, tending to deal with inflation under each system separately. A majority of the materials, especially the more modern ones, expressed contentment with how the Fed has managed the money supply.[42] In either case, few authors acknowledged the existence or viability of any alternative systems, focusing only on strategies for better central management.

The Austrian Critique of the Gold Standard

The Austrian School of economics has long held as its core values the view that a free and open market economy, private property, and sound money would maximize economic freedom and prosperity. It attempts to construct and point to the merits of a noncoercive organization of society and show the deleterious and necessary effects of arbitrary intervention into that society. These themes were dominant in nearly all the social sciences before the rise of the centralized and total state of the twentieth century. Indeed, these are pillars of classical liberalism. As Ludwig von Mises explains, "Defense of the individual's liberty against the encroachment of tyrannical governments is the essential theme of the history of Western civilization" (1980, p. 454). The preference for the gold standard among Austrians is not born out of nostalgia for previous eras or a belief that gold is the perfect money or a cost-free monetary alternative, but quite simply, that historically, gold freely arose as the preferred choice of market participants. Its voluntary selection time and again throughout history supports that it is the most suitable medium-of-exchange available in the world (Garrison in Rockwell 1992, p. 62).

There are a few basic propositions which Austrians hold about money. First, that in a market economy free from forceful intervention, the tendency will be for one or at most a few suitable commodities to begin to serve as a common medium-of-exchange. Second, that these commodities will tend to have certain characteristics that make them particularly suitable for this purpose (Garrison in Rockwell 1992, p. 62). Historically, gold has proven to be most suitable for this purpose, with silver having similar qualities, but to a lesser extent. As Murray Rothbard explains,

[41] See, for example, Byrns (1989, p. 223).

[42] Ekelund (2000, p. 815) put it this way: "In the United States, the Fed has amply demonstrated its willingness to gradually reduce the inflation rate during the 1980s and 1990s. This would appear to take some of the steam out of the argument for a return to the gold standard."

> 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. (Rothbard in Rockwell 1992, pp. 7–8)

When Austrians defend the gold standard, they are really only defending the right for people to voluntarily direct their own affairs. They are merely upholding the fundamental tenants that underlie all peaceful social cooperation (Mises 1998, p. 168). Supporting the gold standard is supporting the veracity that voluntary exchange is beneficial to all parties involved and that coercion cannot produce a more socially beneficial arrangement. It is completely wrong to believe that the gold standard was rejected by the market or somehow failed. It did not fail. It was violently abolished by governments because it did not serve their inflationary schemes (Mises 1980, p. 461).

Indeed, the principles of sound money have always stood firmly in the way of government machinations that can only be brought about by deceptive means. As Austrian economist Richard Ebeling explains,

> looking over the broad sweep of history, it [is] absolutely clear . . . that the history of money [is] nothing less than one long tragic account of incessant state debasement of the monetary unit and an accompanying disruption of economic progress and social development. From the coin clipping of ancient kings and princes through the tidal wave of paper money inflations to the manipulative subterfuge of modern central banking, political influence or control over money and banking had brought in its train nothing but economic havoc and social conflict. (Ebeling in Rockwell 1992, pp. 43–44)

This is the single greatest merit of the gold standard, that it immunizes the market from disastrous state intervention. The benefits of this alone far outweigh the trivial technical or resource cost arguments against the gold standard (Rockwell 1992, p. xii). The frequently cited real costs that a gold standard implies, like the mining and transportation of gold, are not accurately measured by the proponents of these arguments.[43] Simply measuring

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[43]Many mainstream academics attempt to calculate a real figure to determine the costs a gold standard would impose on the economy. Typical estimates range from 16 percent to 50 percent of the annual growth rate of national income. Roger Garrison (in Rockwell 1992, pp. 62) warns against such incorrect calculation.

> Proponents of the gold standard would be ill-advised to respond with a cost figure of their own. If the true costs of a gold standard could be calculated at all, it would have to take into account the monetary instability associated with alternative standards and the consequent loss of output. . . . An appreciation of these benefits, but not a precise quantitative estimate, can best be gained by comparisons of historical episodes which are illustrative of economic performance under a gold standard and economic performance under a paper standard.

the costs of mining gold versus the costs of printing and managing the money supply is not relevant. Each system must be reviewed as a whole, including all costs and benefits. As Roger Garrison (in Rockwell 1992, p. 76) states, "Ultimately, the cost of any action, commodity, or institution is the alternative action, commodity, or institution forgone. The opportunity cost is the only cost that counts." The complete true costs of centralized monetary systems should include both the apparent costs of printing and managing the money supply and the far more relevant and costly effects of the instability associated with these systems. When viewed as a whole, the benefits of a gold standard over other systems are apparent (Garrison in Rockwell 1992, p. 63).

Governments have long understood that their interests and those of the people under them do not frequently coincide. That is why they have had to resort to subterfuge to bring about their schemes. Inflation is really a hidden tax that only benefits the government and whatever social class it chooses to favor with any given policy.[44] Inflation cannot create jobs or wealth, it can merely redistribute them, and by virtue of the necessity of force, which contradicts voluntary exchange, it must create a less socially beneficial outcome. Policies, which could not be undertaken absent inflation, lull the people into thinking that governments possess some "magical powers to turn stones into bread" (Ebeling in Rockwell 1992, p. 44).

Political leaders favor inflationary policies because they hide the real costs of their programs until after they have seized greater control or have left power. These political leaders, as Mises pointed out, can only pursue these extremely popular policies by misleading the people and undermining

> the democratic way of persuading the majority. They arrogate to themselves the power and the moral right to circumvent the will of the people. They are eager to win its cooperation by deceiving the public about the costs involved in the measure suggested. . . . Inflation is the fiscal complement of statism and arbitrary government. (Mises 1980, p. 468)

It is for this reason that most Austrians support a 100 percent gold standard as the only system fully compatible with the free market and the defense of property rights.[45] Any standard that allows banks or governments to

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[44]Mainstream economics is inured with the benefits that inflationary schemes can supposedly provide. Arguments abound that inflation spurs economic growth, reduces unemployment, cures monetary disequilibrium, and can provide a stable money. All of these arguments have been systematically refuted in the Austrian literature. For further reading on these subjects, see the following resources. Monetary disequilibrium: Cochran (2001) and Horwitz (1996). Stable money: Dorn (1987) and Herbener (2004).

[45]Given the way the Austrian School has historically approached the topics surrounding money and its functions within an economic system, it should be of little surprise that a number of its more prominent Authors have produced works that adequately address the many relevant issues surrounding the gold standard and sound monetary policy. Perhaps no author has been more prolific than Murry Rothbard. Following closely in the footsteps of Ludwig von Mises and the work he did in *The Theory of Money and Credit*

expand credit beyond the observed preferences of market participants creates fraud and instability. As Rothbard notes, "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 on the proverbial henhouse" (Rothbard in Rockwell 1992, p. 2).

CONCLUSION

This paper has attempted to survey, primarily, how modern economic textbooks have addressed the various topics surrounding the gold standard, and secondarily, to analyze how the Austrian School has addressed these same topics. This survey shows that the situation in modern textbooks is really quite unbalanced. Their failure to provide adequate information about the gold standard is only exceeded by their failure to recognize the relevant facets of a gold standard and provide systematic argumentation for and against them. Regrettably, the situation with the textbooks is somewhat understandable given the ideological bent of modern economics.[46]

(1912) and the sections on indirect exchange in *Human Action* (1949), Rothbard focuses heavily on the fundamental issues related to sound money that are crucial for a market economy. Rothbard's *What has Government Done to Our Money?* (1964) is perhaps the best introduction to this topic available. In a little over a hundred pages, he systematically addresses the history of money, its functions and properties in a free society, and the effects of government's meddling with the money supply. While the depth of information covered in this monetary essay is light at times, Rothbard makes up for this by the scope and integration of all these topics into a cogent and clear view of money. He starts by looking at the concepts of barter and exchange and building the concepts of the monetary unit, private coinage, and fluctuations in the money supply upon this "Crusoeian" economic foundation. Then, introducing government into the equation, he examines legal tender laws, debasement, inflation, and fiat money, concluding with a history on the monetary breakdown of the West.

In Rothbard's equally substantial essay *The Case Against the Fed* (1994), he extends his analysis of monetary issues to the important subjects of banking and centralized planning of the money supply, showing in classic form the deleterious effects of monopolized power. While his *Making Economic Sense* (1995) is a collection of essays not specifically dedicated to topics relating to money, whenever topics related to money surface, Rothbard guides the reader through the sound monetary interpretation of the events and phenomena. But Rothbard's seminal work, *Man, Economy, and State* (1962), is where he goes into the greatest detail establishing the principles of economic reasoning concerning money. There are a number of other articles and resources on related topics on the Ludwig von Mises Institute website: www.mises.org.

[46]Today, most economists live off the state, whether through its subsidization of the public university system or its own hiring of economists in an attempt to support or legitimize its policies. It should be of little surprise then that the twentieth century saw the profession transformed from its laissez-faire roots to the statist doctrines that rule the day now. Many of its chief practitioners are merely creatures of the state rejecting thorough, systematic, and honest academic work in favor of the subterfuge of statist and collectivist ideologies. See Salerno (2004).

The most persistent problem preventing these texts from systematically and honestly presenting their arguments is that long before they arrive at the subject of money and the gold standard, a goliath expansionist and interventionist government has already been assumed as necessary or beneficial for society. As Mises stated so succinctly in *Theory of Money and Credit*, "It is impossible to grasp the meaning of the idea of sound money if one does not realize that it was devised as an instrument for the protection of civil liberties against despotic inroads on the part of governments. Ideologically it belongs in the same class with constitutions and bills of rights" (Mises 1980, p. 454).

It is quite rare to find a textbook that even begins to approach and engage the core issues of importance concerning the gold standard. This is one area where the Austrian literature really stands out. They have gone to great lengths to systematically approach this topic, to fairly rebut the alternative arguments, and methodically rework their arguments to respond to the major claims against them.

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