Money and Freedom
Hans F. Sennholz
Spring Mills, Pa.: Libertarian Press, 1985, 88 pp.

Proposals to improve the system (any system) are a dime a dozen. Even at that price, they are in excess supply. This is particularly true of proposals to reform governmental institutions, and there is a good reason for it: "In government as in business we must try to set up institutions under which individuals who intend only their own gain are led by an invisible hand to serve the public interest."[1] The rub is that economists have only partially uncovered the workings of the invisible hand in government. The field of Public Choice is in its infancy. We may not like certain outcomes that our institutional arrangements produce, but until we understand how these institutions operate on the system of incentives facing government policymakers, any proposal for reform is no more than a shot in the dark. The little book by Hans F. Sennholz is an example.

Sennholz is troubled by the apparent inflationary bias of our monetary system. Persistent inflation taxes money holding. A reduced quantity of real money balances is held, and there is a welfare cost associated with this (i.e., the costs imposed on money holders exceed the revenue generated by the tax). Although it is never clearly put, this welfare cost is the basis for Sennholz's complaint.

Most would agree that inflation is a nettlesome problem. People can learn to live with it but they would rather be spared the lesson. Everyone prefers a low and stable rate of inflation if it can be achieved at the right price.[2]

Proposals to lick inflation are worthy of consideration if they are based on a careful analysis of existing monetary institutions so that we can identify the arrangements that induce policymakers to choose inflation over price stability. The analysis must indicate how the existing institution(s) can be altered to produce the desired results. Finally, it is important to compare estimates of the costs and benefits of making the change. It may be that the existing set of monetary institutions is optimal even though they contain an inflationary bias.

Sennholz does none of this in his book. Instead, he asserts that he has identified the offending institutions and that his alternative arrangements would produce net benefits. Without the analysis, however, the discussion strikes the reader as idle speculation.

In Sennholz's view, inflation is a natural consequence of the monopoly production of money by the government (p. 11). In the United States, the government's agent is the Federal Reserve System, whose notes are granted legal tender status (pp. 14, 24, 27). Sennholz is never clear about whether

[1]Milton Friedman, "Economists and Economic Policy," *Economic Inquiry* 24 (January 1986): 2.

[2]Sennholz never distinguishes between the problems of anticipated and unanticipated inflation. Both transfer wealth from money holders to the money issuer as outlined above. In addition, the latter transfers wealth between private net monetary creditors and debtors. These two problems are confused in Sennholz's discussion.

inflation is due to the government's monopoly, the Federal Reserve, legal tender or all three of these. This is an important question since the scope of the proposed reform (and its cost) depends on the answer. The approach used by Sennholz is reminiscent of an episode that occurred during the Albigensian war. A French duke, upon attacking a predominantly Albigensian town in which some faithful Catholics were known to reside, was ordered to "kill them all and let God identify his own."

Sennholz calls his proposed alternative the "parallel standard" (p. 81). The important characteristics of this standard are: the minting of gold and silver coins denominated only by weight; repeal of legal tender laws; permission to issue private notes by financial institutions; free entry into banking; interstate banking; the end of mandatory Federal Reserve membership; and prevention of tax discrimination against all forms of money (p. 81).

Many may find some or all of these provisions attractive. My criticism of Sennholz's book does not turn on this. Rather, I believe that his book does nothing to improve our understanding of how the invisible hand in government works to produce an inflationary bias nor does it detail how the parallel standard would structure government incentives differently to produce the desired result. Sennholz asserts that implementation of his alternative would end inflation (p. 80); eliminate financial crises (p. 82); make the business cycle obsolete (p. 15); and promote honesty, decency, and peace (p. 79). The benefits that Sennholz claims are too fantastic and too much at odds with the facts to be taken seriously.

As I read the proposal, it suggests monetary arrangements similar to those of the free banking period (1837–63). But the historical data concerning this period do not support the grand claims Sennholz makes. The period was not one of price stability. Prices declined at an average annual rate of about −7.0 percent from 1837 to 1843, rose at a rate of 2.8 percent from 1843 to 1857, fell at a rate of −5.5 percent from 1857 to 1861, and rose at a rate of about 20.0 percent from 1861 to 1863.[3] Business recessions and financial crises occurred in 1837, 1842, 1857, 1859, and 1861.[4] Finally, for whatever it's worth, the free banking period came to an end in the midst of the most bloody war ever fought within our borders.

In summary, Sennholz's book reminds me of a story that Senator Sam Irvin was fond of telling. Upon being fired, a country preacher asked the church deacons to explain their action. The preacher asked the chairman, "Didn't I argufy?" The chairman answered, "You sure did argufy." The preacher inquired, "Didn't I sputify?" The chairman responded, "You sure did spu-

[3]The price level measurements are taken from the Warren and Pearson Wholesale Price Index. For a thorough discussion of price level variation under different monetary standards, see Benjamin Klein, "Our New Monetary Standard: The Measurement and Effects of Price Uncertainty," *Economic Inquiry* 13 (December 1975): 461–84.

[4]See Arthur J. Rolnick and Warren E. Weber, "Inherent Instability in Banking: The Free Banking Experience," *Cato Journal* 5 (Winter 1986): 877–90.