# Law, Legislation, and the Gold Standard

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> Isn't it perplexing that people who advocate a return to the gold standard are often against big government and supposedly pro-market? After all, the term "gold standard" is just a euphemism for government price fixing where the government sets an arbitrary, non-market price for the currency/gold conversion. By now humans should have learned that government price fixing almost always leads to a host of bad, unintended consequences.
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> —*The Motley Fool* (2010)

More than a half century ago, in October 1961, Milton Friedman's "Real and Pseudo Gold Standards" appeared in the *Journal of Law and Economics*. In that article, Friedman argued that versions of the gold standard erected after 1914, if not some earlier ones, were "pseudo" gold standards, differing from "real" ones in dispensing with actual gold coins and allowing monetary authorities to sterilize international gold movements, instead of letting those movements automatically regulate national money stocks. Such pseudo gold standards, Friedman argued, amounted to particularly dangerous instances of government price-fixing, and as such ought to be anathema to believers in free markets.

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Here I wish to suggest a different distinction, inspired by the 40th anniversary of Friedrich Hayek's Nobel Prize in Economics in October 1984. The distinction I wish to emphasize is based on the one that forms the subject of the opening volume of Hayek's ambitious post-Nobel Prize work, *Law, Legislation, and Liberty*. It is that between a gold standard founded on custom-based or "private" law, and one resting upon statute or "public" law, that is, on government legislation.

I plan to argue that this Hayekian distinction is related to, but more fundamental than, the one Friedman insisted upon. But before I can do so I must first review the difference between custom-based law and legislation, and then show how the development and flourishing of the historical gold standard depended more on the former than the latter. I will then go on to argue that any gold standard based on legislation only, and not on customary law, is unlikely to endure. Because a spontaneous return to gold-based payments is itself highly unlikely, I conclude that, even setting general opposition to the idea aside, there is little prospect for an enduring gold standard revival.

## Customary versus Statute-Based Law

Law, according to Hayek, must not be identified with legislation. Although legislation (the corpus of edicts, statutes, and regulations enacted or adopted by government authorities) is itself a source of law, it is neither the most important nor the oldest source. "Law," Hayek (1982: 73) reminds us, "existed for ages before it occurred to man that he could make or alter it." Instead of being imposed by political authorities, such traditional or custom-based law, the best examples of which are the common law and law merchant (itself absorbed into the English common law during the 17th century), is "discovered" by judges though their attempts, in adjudicating cases, to determine how pre-existing, if tacit, rules of just conduct appertain to them.[1] Though legislation may also codify customary laws, it consists by and large, not of generally applicable rules of just conduct, but "of directions

[1]As Benn Steil and Manuel Hinds (2009: 18) observe, although the fact has been obscured by "the Napoleonic practice of codifying national law based on the Roman inheritance," Roman jurisprudence "itself shares with uncodified English common law a genesis wholly outside the realm of political expression."

concerning what particular officers or agencies of government are required to do" (ibid.: 133). Because custom-based law instead mainly governs relationships between private individuals, the distinction between it and legislation conforms roughly to that between "private" and "public" law (ibid.: 131).

Because it is "discovered" rather than "made," customary law differs from legislation in being backward-looking and largely "purpose independent": it seeks to discern and enforce established if implicit codes of conduct. Legislation in contrast tends to look forward to the accomplishment of some particular end or ends, and as such is necessarily based on the perceived expedience of the rules it puts into effect. Because of this, legislation is always subject to reconsideration and revision. It is, in other words, inherently provisional. The likelihood that it will go unaltered tends, furthermore, to decline over time as circumstances change from those that prevailed at the time of its adoption. Customary law, in contrast, is subject at most to very gradual or evolutionary, but never sudden, change. "Public law passes," Hayek (ibid.: 135) succinctly observes, "but private law persists."

The difference between private or customary law and public law or legislation is, I submit, one of great importance for a proper understanding of the gold standard's success. For, despite both appearances to the contrary and conventional wisdom, that success depended crucially upon the gold standard's having been upheld by customary law *rather than* by legislation. It follows that any scheme for recreating a durable gold standard by means of legislation calling for the Federal Reserve or other public monetary authorities to stand ready to convert their own paper notes into fixed quantities of gold cannot be expected to succeed.

## The Essence of a Gold Standard

The general employment of particular goods in making payments, whether in trade or tribute, was itself, so far as can be determined, an outgrowth of pre-monetary customs rather than a product of any deliberate planning or legislation. "It is apparent," the Victorian classicist and archeologist Sir William Ridgeway (1892: 47) observed, "that the doctrine of a primal convention with regard to the use of any one particular article as a medium of exchange is just as false as the old belief in an original convention at the first beginning of

Language or Law."[2] Although no one knows when gold and other precious metals first acquired the status of generally accepted exchange media (i.e., money), that status was well established among the civilizations of early antiquity.[3]

We owe to Sir William as well what remains the most compelling explanation of the origin of the earliest known gold units (Mundell 2002: 7). He is quick to dismiss the view that ancient weight units "had been obtained scientifically" (Ridgeway 1892: 1), which he attributes to a false analogy with the metric system established by the French Republic. "Reflection," Ridgeway says, "might have shown scholars that even the French system was not a wholly independent outcome of science, for beyond doubt the *métre* and *litre* and *hectare* were only varieties of older measures of length, capacity and surface, then for the first time scientifically adjusted." Instead, he argues, ancient gold monetary units were a natural outgrowth of traders' pre-monetary habit of expressing prices in terms of oxen or cows.[4] There was, on the other hand, no such thing as a natural gold unit in which

[2]In contrast, the Chartalist view holds that public authorities invented and introduced money to serve as a convenient medium for the payment of taxes or tribute. That view makes sense only assuming that these authorities were sufficiently important to have formed a bandwagon attractive enough for others to clamor aboard. In light of this one might view the Chartalist view as a special case of the spontaneous evolution theory. Carl Menger (2002: 31), the most well-known exponent of the latter theory, explicitly recognized that goods formerly used for paying dues to chieftans or priests were especially likely to become generally employed as exchange media.

[3]David Graeber's (2011) now fashionable claim that this "outgrowth of barter" theory of money's origins is an invention of ignorant economists, including Smith and Menger, rests entirely on his assumption that the theory was intended to refer to developments *within* tightly knit traditional societies, rather than *among* otherwise independent communities. That barter, far from having occurred only in "a fantasy world" concocted by economists (as Graeber initially asserts) was, prior to the advent of money, the only convenient means of exchange among *strangers*, is a point that Graeber himself eventually admits (ibid.: 29). What he cannot admit, of course, is that the concession effectively rescues the conventional notion that money evolves from a prior "barter economy," subject only to the proviso that the "economy" in question is one encompassing, not a single independent village or tribe, but many.

[4]I say "prices" rather than "values" deliberately, to avoid the troublesome suggestion that values, which are necessarily subjective, can be expressed, let alone measured, in monetary units. Besides being contrary to subjective value theory, this suggestion leads to the false and mischievous idea that money can and ought to be a "measure" of value, and that its own value (purchasing power) ought therefore to be constant.

prices might be expressed. Instead, gold became the first object upon which the art of weighing was practiced, with grain serving as a weighing medium. As oxen were worth about 130 grains of gold throughout the ancient world when gold came to be employed as an exchange medium, that quantity of gold became the basis of the earliest gold units, and eventually of coins representing those units. This simple transition, Ridgeway observes, accounts both for the surprising uniformity of independently developed gold units throughout the ancient world, and for the tendency for the name of the old barter unit to attach itself to the new metallic ones. In ancient Athens, for example, the first current gold coins bore the symbol of an ox, and values continued to be expressed in ox-units, though those units were now represented not by oxen themselves but by their metallic value equivalents. The same development is reflected in the various monetary terms having the latin word *pecunia* as their root.

Despite claims to the contrary dating back to Herodotus, coinage—the packaging of raw metal into units of standard size and purity—was also, so far as can be determined, a private-market development rather than an invention of Gyges, Pheidon, Theseus, or some other ancient tyrant. There is in any event no technical reason why coining, an industrial process, cannot have begun as a private undertaking, as it has occasionally been in more recent times. Kings and princes were nonetheless quick to make the coining of precious metals (and, sometimes, of base metals as well) a royal prerogative. Notwithstanding the naïve belief that governments were obliged to monopolize coinage for the sake of protecting their citizens from abuses to which competitive coinage would expose them, it was not private firms but government authorities themselves who posed the greatest danger of abusing coinage, and who would in fact be responsible for all the more notorious abuses of the power to coin, including countless episodes of debasement stretching from Roman to early modern times. Governments were able, by virtue of their coinage prerogatives and associated power to compel acceptance of their coins at par, to arbitrarily redefine national money units, and to thereby turn former products of commercial custom into playthings of public law.

That metallic units became matters of public law rather than custom might itself have spelled the end of durable precious-metal standards had debasement not ceased, in early modern times, to be an effective means for raising revenue. In England, first and foremost, the debasements of Henry VIII and Edward VI left the coinage in such a state as compelled Elizabeth I to renounce her predecessors' policies and restore England's pre-debasement (silver) standard. A century later, when merchants' resort to goldsmiths' notes again threatened to undermine the demand for coin, the government took the next logical step, in 1666, of renouncing debasement altogether, by ceasing to coin on its own account and instead devoting its mints (in unconscious imitation of a competitive coinage system) to the "free" (i.e., unlimited) coinage of metal on private account.[5] Other European nations eventually followed a similar course.

Although coin debasements thus became a thing of the past, standard money units remained matters of public law. This vestige of ancient legislators' interference in money's free development was to play a crucial role, first in the substitution throughout Western economies of the gold standard for previous silver and bimetallic standards, and eventually in that standard's own undoing.

## Paper and Gold

In the absence of banks, having a gold standard simply means having coins embodying standard gold units serve as generally accepted exchange media. But where banks also supply exchange media, having a gold standard means that money consists either of gold coins or of bank notes and deposits that are reliable *representatives* of the standard gold unit.

Banknotes, the first paper substitutes for coin, were originally resorted to because government abuse of coinage confronted merchants with a hodgepodge of coins, many of them debased or otherwise impaired to some degree. "The superscription of the bank upon a piece of paper," Elgine Groseclose (1934: 70) observes, "became a better certificate of valid money than the seal of the state upon the coin, and because it was not, like coin, subject to wear and abrasion, it became a more acceptable medium of payment than the actual metal." In England goldsmiths rose to prominence as bankers and note issuers after Charles I, in 1640, seized £120,000 of precious metal that had been delivered to the Tower of London for coining. William Paterson later adopted the goldsmiths' idea in proposing the

[5]Besides making coinage free, the 1666 reform made it "gratuitous" as well, with coinage expenses paid out of the general revenues.

Bank of England as a device for funding England's involvement in the War of the Palatinate.

Paterson wanted the Bank's notes declared legal tender, but Parliament balked at the suggestion.[6] Consequently the Bank's notes continued, along with other commercial banknotes, to be private IOUs, circulated and redeemed by custom only, akin to today's commercial bank deposits. Indeed, commercial banknotes involved stricter obligations than, say, foreign bills of exchange, in that anyone holding such notes was considered prima facie a holder in due course, who was therefore excused from having either to lodge a formal protest in the event of nonpayment or to notify the banker of such protest. Consequently a bank that refused payment on a note was automatically held to have dishonored it, and thus to have committed an act of bankruptcy, giving the holder an immediate right of recourse for breach of contract, including the right to prove upon the bankrupt bankers' estate for the refused amount (Byles 1891: 10–11, 291, 461). Although banknote issuance became increasingly subject to special statutory regulation over the course of the 19th century, in many Western nations, and in Anglo-Saxon legal systems in particular, "It was taken for granted that the general freedom to contract . . . extended to issuing notes and establishing credits by lending or discounting," and not merely to the making of loans funded by deposits (Hurst 1973: 152).

The modern gold standard can thus be said to have involved not one but two kinds of commitments. The first consisted of mints' commitment to supply coins in exchange for gold bullion at a stated "mint price" of bullion. The second consisted of banks' commitment to supply gold coins in exchange for their paper promises on demand. While the sustainability of a gold standard depended on the credibility of both of these commitments, what sealed the fate of the gold standard or, more precisely, of attempts to reconstruct that standard after the World War I, were reforms that served, albeit quite unintentionally, to permanently and

[6]Much later, in 1833, the Bank Notes Act made Bank of England notes of over £5 legal tender in England and Wales. The Currency and Bank Notes Act of 1954 extended legal tender status to smaller-denomination Bank of England notes. In Scotland today neither Bank of England notes nor Scottish commercial bank notes are legal tender.

fatally undermine the credibility of commitments to convert paper into gold.

## The Classical Gold Standard

The classical gold standard, which prevailed throughout much of the industrialized world between the early 1870s until the outbreak of World War I, is frequently portrayed by critics and enthusiasts alike as an instance of government price-fixing and, hence, as a product of legislation. Michael Bordo (2008), for example, claims that "The gold standard was a commitment by participating countries to fix the prices of their domestic currencies in terms of a specified amount of gold. National money and other forms of money (bank deposits and notes) were freely converted into gold at the fixed price" (compare Eichengreen 2011).

This interpretation is, however, anachronistic and misleading: it views pre-1914 monetary arrangements through the lens of the post-1914 advent of deliberately designed (if nonetheless chaotic) international monetary schemes. In truth, the classical gold standard was to a considerable degree a spontaneous development, founded not on statutes but on customary law. Legislation did play a part, of course, as was bound to be the case given that governments monopolized coinage, thereby making basic metallic coin units themselves objects of public rather than customary law. And though more advanced 19th century governments had ceased to resort to debasement, this did not prevent them from occasionally altering units' metallic content, implied mint prices, and (where bimetallism prevailed) mint silver to gold ratios. It was, indeed, partly in consequence of such alterations, and partly due to the changing relative worth of gold and silver, that gold monometallism came to displace bimetallism in country after country during the first three quarters of the 19th century.

Yet, both the working and the duration of the classical gold standard can be said to have owed more to commercial custom than to legislation. Regarded as an international regime, the gold standard was, first of all, not the result of any international collaboration, but, as Leland Yeager (1984: 662), observes, "Simply an additional outcome of a group of nations . . . unilaterally adopting gold standards in the 1870s," the mechanics of which "were primarily the resultants of private transactions in the markets for goods and money" (see also Gallarotti 1995). Just as importantly, the so-called rules of the classical gold standard game were rules enforced by the private law of contracts, not by public laws.

Private contracts rather than public laws were, in particular, responsible for what so many commentators wrongly regard as the "fixing" of gold's price—that is, the fact that paper currencies could be converted into definite quantities of gold. This convertibility was proof, not of any sort of government price-fixing, but of the fact that during the period in question currency consisted mainly of commercial banknotes that were considered binding promises to pay. Many participating nations, including the United States, Switzerland, Canada, Australia, and (until 1901) Sweden, did not even have central banks enjoying exclusive note issue privileges for which they were indebted to their governments. Moreover, most of the privileged banks that did take part, the Bank of England among them, were still private institutions generally subject to the same private-law sanctions applicable to commercial banks. Testimonials by representatives of these central banks, gathered by the U.S. National Monetary Commission between 1908 and 1910, show that they "carried on in a state of relatively high independence from the public domain" (Gallarotti 1995: 24).

In short, countries abided by the rules of the gold standard game because that game was played by private citizens and firms, not by governments.[7] The contrary view of the classical gold standard as a system deliberately kept to serve "as a contingent rule or a rule with escape clauses" (Bordo and Rockoff 1996: 389), or for any other national or international purpose, may do as an "as if" theory, but *not* as an accurate portrayal of how that standard actually came to be, or why it survived as long as it did. The standard didn't last merely or mainly because government authorities appreciated its advantages, fiscal and otherwise, and were anxious to take full advantage of them. Rather, it was kept going by private laws that governments were generally unwilling to contravene. Put

[7]Nor did the Bank of England manage the classical gold standard, as it often asserted. As Gallorotti (1995: 140) notes, "Not only can we say that the Bank did not manage the international monetary system, but it is questionable whether it even managed the British monetary system."

yet another way, pre-1914 gold pegs were hard not because government policies made them so, but because the pegs actually had little to do with government policies.

## The Gold Standard's Undoing: From Contract to Policy

Although it may seem paradoxical, our understanding of the classical gold standard suggests that, if that standard had been deliberately set up by governments to enhance their borrowing ability, it is unlikely that it would have worked as intended. This conclusion follows because, once public (or quasi-public) authorities, governed by statute law rather than the private law of contracts, become responsible for enforcing the rules of the gold standard game, the convertibility commitments crucial to that standard's survival cease to be credible.

A change of the sort just described, which had already begun to weaken the foundations of the classical gold standard in the decades prior to World War I, was to play a crucial albeit heretofore unacknowledged part in the failure of post-WWI attempts to reconstruct the classical gold standard. The change was mainly due to the spread of central banking and the subsequent tendency of private law courts (referring as usual to prevailing commercial custom) to treat central banks' paper notes, not as so many negotiable instruments, but as money proper (Mann 1992: 16, 19). The change was facilitated by legislation conferring legal tender status on central bank currency. But it was also a consequence of non-note-issuing banks' practice, itself often reinforced by legislation, of employing central bank notes and deposits as reserves rather than as so many IOUs in need of collection. That habit, in turn, caused central banks to become their nations' sole custodians of gold, and therefore the only banks responsible in normal times both for managing their nations' gold stocks and for converting paper money into gold.

Once they found that central bank notes were being treated by commercial bankers as "definitive" money, it was only natural for private law courts to take the further step of holding a central bank's decision to devalue its currency to be "an exercise of sovereign authority which does not give rise to a cause of action against the nation in question" (Shuster 1973: 57). Central banks thus came to inherit the monetary prerogative originally asserted by monarchs, and exercised by them through their control of coinage, including the ability to arbitrarily redefine monetary units. This change in the legal status of central bank currencies allowed central bankers to suspend convertibility and, eventually, to devalue their currencies, with impunity.[8]

It might seem that the developments just described need not have doomed the gold standard, since central bankers, and more independent ones especially, might have refrained from devaluing their paper currencies, just as past governments eventually abjured debasement. But the analogy is misleading, for a gold standard founded on commitments to which sovereign immunity attaches, and therefore no longer bolstered by the private-law sanctions applicable to other banks when they dishonor their promises, is necessarily one in which the commitment to maintain a gold parity ceases to be credible. Knowing that central banks can devalue with impunity, and that they may even profit by so doing, holders of a central bank's currency have good reason to fear that it might devalue, especially if it has already done so in the past (Selgin and White 2005: 73). Gold pegs enforced by central banks are for this reason just as likely as any central-bank-based fixed exchange-rate scheme to eventually succumb to a speculative attack. The general proliferation of central banks, starting with the Federal Reserve's establishment in 1914 and accelerating during the 1920s and 1930s thanks to campaigning by Edwin Kemmerer and Montegue Norman, and to resolutions adopted at the Brussels Conference of 1920 and the Genoa Conference of 1922, may thus be said to have played no less important a role than World War I in sealing the fate of the gold standard, for it was that development that undermined, as war itself could not, the private legal foundation upon which the classical gold standard's success had rested. The war severed belligerent nations' monies from their previous gold moorings, but it was mainly other developments—and the spread of central banking especially—that ruled out the possibility of ever making those moorings secure again, regardless of chosen gold parities.[9] Indeed, the

[8]According to Mann (1992: 19), paper banknotes constitute definitive money in law, and hence can have their redemption value arbitrarily manipulated by their issuers "only if they are created by or with the authority of the State or such other supreme authority as may temporarily or de facto exercise the sovereign power of the State." By contrast, notes issued by ordinary commercial banks "do not in law possess the attributes and privileges" of definitive money.

[9]On the post-WWI spread of central banking see Helleiner (2003: ch. 1).

same developments would ultimately doom not just attempts to reestablish some kind of gold standard, but all attempts to reestablish a durable system of fixed-exchange rates.

This outcome was as ironic as it was tragic, for it could not have been more contrary to the intentions of the very people who insisted, in the language of the Brussels resolution, that "in countries where there is no central bank, one should be established." These advocates of central banking, informed perhaps by the very misunderstanding of the nature of the classical gold standard to which we have drawn attention, were convinced, against all experience, that central banks alone could be relied upon to "insulate national monetary management from the control of political forces" (Helleiner 2003: 148)

## Ethos versus Contract

Writings on the classical gold standard are sprinkled with references to the "ethos" of that standard (e.g., Eichengreen 1992: 22) or to the "laissez-faire ethic" or "metallist norms" that held it in place (Gallarotti 1995: 7, 28). The general thinking that such terms represent is perhaps best summarized by Leland Yeager's (1984: 663–64) statement that "the gold standard before World War I hinged on favorable conditions that no longer prevail," including "a laissez-faire atmosphere" that "favored limitations on the scope of government activity and restraint on seeking special advantage through the instrumentality of government." It follows, according to Yeager, that "without a return to liberal attitudes and self-restraint, a restored gold standard would not work well and would hardly endure. After all, the gold standard is simply a particular set of rules for policy regarding the monetary system; and these rules are no more inherently self-reinforcing than any other set of monetary rules."

While it is of course hard to imagine any revival of the gold standard unaccompanied by a "return to liberal attitudes," or (to be more specific), *classical* liberal attitudes, there is an important sense in which Yeager's position, and that of others subscribing to the ethos view of the gold standard's underpinnings, is misleading. For as we have seen the classical gold standard was *not* at bottom "a particular set of rules for *policy*," as it would have been had it rested solely or primarily on statute law. Instead it was, while it lasted, grounded mainly in customary law, including the common law of contracts. And because adjudication of such law tends to be backward-looking, rules based upon it—including the "rules" of the classical gold standard—*are* self-reinforcing in a way that statute-based rules, monetary or otherwise, are not. A change in ethos in Yeager's sense alone did not, in fact, doom the gold standard, for the authorities who undertook to reconstruct the international monetary system in the aftermath of World War I were for the most part both steeped in that ethos and determined to reconstruct the institutions to which it supposedly gave rise. Their failure was due not to their having turned their back upon prewar values, but to their having tragically misunderstood the true legal foundations of the arrangement they sought anxiously and sincerely, not only to recreate, but to strengthen.

## Friedman on Real and Pseudo Gold Standards

My remarks in the last sections concerned the manner in which currency centralization contributed to the destruction of the gold standard by undermining the *credibility* of gold redemption pledges, and not the effects of such centralization on the workings of the standard, and especially the pattern of short- and long-run adjustments of national money stocks and price levels to which it gave rise. The two subjects are nevertheless closely related, both because speculative attacks upon untrusted convertibility schemes themselves alter patterns of monetary adjustment, and because the unique ability of central banks to manage gold flows could itself result in such departures from the requirements for long-run international monetary equilibrium as might themselves lead to exchange crises (see Gallarotti 1995: 181–217; Hayek 1937).

By a "pseudo gold standard," Friedman meant an arrangement involving one or more national central banks charged with fixing the price of gold. He was not concerned with the low credibility of the pledges implicit in such price fixing, but with central banks' ability to sterilize and thereby deliberately manipulate international gold flows, and thus undermine the market forces that tend, under a real gold standard, to preserve international monetary equilibrium. Friedman (1961: 67) wrote:

> My thesis is that current proposals to link national currencies rigidly to gold whether at present or higher prices arise out of a confusion of two very different things: the use of gold as money, which I shall call a "real" gold standard; governmental fixing of the price of gold, whether national or international, which I shall

> call a "pseudo" gold standard. Though these have many surface features in common, they are at bottom fundamentally different—just as the near identity of prices charged by competitive sellers differs basically from the identity of prices charged by members of a price-ring or cartel. A real gold standard is thoroughly consistent with liberal principles, and I, for one, am entirely in favor of measures promoting its development, as, I believe, are most other liberal proponents of floating exchange rates. A pseudo gold standard is in direct conflict with liberal principles, as is suggested by the curious coalition of central bankers and central planners that has formed in support of it.

He goes on to say, regarding the various post–World War I attempts to reconstruct the gold standard, that

> either a real gold standard throughout the 1920's and '30's or a consistent adherence to a fiduciary standard would have been vastly preferable to the actual pseudo gold standard under which gold inflows and minor gold outflows were offset and substantial actual or threatened gold outflows were over-reacted to. And this pattern is no outmoded historical curiosity: witness the United States reaction to gold inflows in the early years after World War II and its recent reaction to gold outflows; witness the more recent German sterilization of gold inflows. The pseudo gold standard is very much a living menace [Friedman 1961: 72].

Unlike our distinction between a gold standard established and enforced by customary law and one established or enforced by means of legislation, Friedman's distinction between real and pseudo gold standards refers not to any difference in their legal foundations but only to the different forms of money involved in each. In a pseudo gold standard these include the fractionally backed (fiduciary) liabilities of central banks or other official monetary authorities. Actual gold coins, on the other hand, need not be employed. In a real gold standard, in contrast, money consists, first of all, of actual gold coins. But it may also consist of either warehouse receipts fully backed by gold or of the promises of either

> private persons or governments . . . to pay gold either on demand or after a specific time interval which were not

> warehouse receipts but nonetheless were widely acceptable because of confidence that the promises would be redeemed. Such promises to pay would still not alter the basic character of the gold standard so long as the obligors were not retroactively relieved from fulfilling their promises, and this would be true even if such promises were not fulfilled from time to time [Friedman 1961: 75–76].[10]

Although Friedman comes close to recognizing the different legal foundations we have outlined, one of which makes gold redemption pledges as binding contracts, while the other makes them a form of government price fixing, he never actually refers to them. Moreover, in allowing that a real gold standard might involve promises to pay issued by "private persons *or governments*," he overlooks the tendency for sovereign immunity to attach to government actions. It is for this reason that I regard the distinction between a gold standard resting on private contracts and one resting on statute law to be of more fundamental importance than Friedman's distinction between real and pseudo gold standards.

## A Spontaneous Return to Gold?

I turn now to consider some implications of our analysis of the legal foundations of the historical gold standard for the prospect of a gold standard revival.

The classical gold standard consisted, as we've seen, of a combination of official coinage policies with largely private arrangements guaranteeing the convertibility of paper currencies into gold. It is therefore tempting to suppose that to revive the gold standard it will suffice to make gold coins available again, by providing for their free coinage either by government or private mints, while allowing private contracts to guarantee the convertibility of gold-denominated bank notes and deposits into equivalent amounts of coin itself.

[10]Friedman adds that "Such a system might and I believe would raise grave social problems and foster pressure for governmental prohibition of, or control over, the issue of promises to pay gold on demand," referring readers to the arguments in his *Program for Monetary Stability*. Friedman would later revise his views on private versus government supply of currency (Friedman and Schwartz 1986), though without entirely freeing himself of the parochialism upon which his earlier stand rested (see Selgin 2008).

Thus, Richard Timberlake (1995) proposes that the U.S. government privatize the Treasury's gold stock, which, according to official records, consist of over 8,000 tons of the metal stored mainly at Fort Knox, by first offering one-ounce, marketable "gold certificates" to taxpayers, and then supplying bullion itself to those presenting sufficient quantities of such certificates. Private firms might then go into the business of converting bullion into coins of "convenient denominations," by which Timberlake means not existing dollar units—for the new coins would have no set dollar value—but merely convenient indicators of the coins' gold content. Gold coins could then

> become the basis for special bank-administered checking accounts [that] would develop monetary functions. Gold depositors who wished to transact in this medium would have checkbooks appropriately identified with gold logos, and would write checks to anyone who would accept title to the designated quantity of gold as payment for a debt. Gold reserve banks would clear gold balances with each other based on their daily or weekly debits and credits. They would perforce redeem deposits on demand in gold for any gold depositor who so wished. Eventually, borrowers might base their loans on gold, whereupon the gold would complete its restoration as a viable money [Timberlake 1995].

Some authorities suppose that a sufficiently rapid deterioration in the fiat dollar's purchasing power could suffice, even apart from the steps Timberlake proposes, to spur a spontaneous gold revival. According to George Reisman (1998: 951), for example, "If not prevented from doing so by government interference, the market itself would take all of the necessary precautions against the destruction of money, by preparing the ground for the reemergence of gold and silver as money."

> As inflation becomes perceived as a serious problem, a growing demand for gold and silver develops as an "inflation hedge"—i.e., as a store of value. Once this demand reaches a certain level, the stage becomes set for a spontaneous remonetization of the precious metals. For, just as in the process by which the precious metals became money in the first place, once enough people want to own gold and silver as an inflation hedge and thus are willing to accept them in exchange for

> their own goods and services, others become willing to accept them too, even though they themselves do not wish to hold them as an inflation hedge or store of value. Conditions exist, in other words, for a growing acceptability of the precious metals, to the point at which they become universally acceptable, i.e., become money once again [Reisman 1998: 511].

The prospects for a "spontaneous" gold standard revival are, however, considerably dimmer than such scenarios suggest. "The dollar," Lawrence White (2012: 413) explains,

> has an incumbency advantage due to the network properties of a monetary standard. The greater the number of people who are plugged into the dollar network, ready to buy or sell using dollars, the more useful using dollars is to you. Conversely, if you are the first on your block to go shopping with gold coins or a gold-denominated debit card, you will find few stores ready to accept payments in gold.

The public has, to adopt a phrase from the economics of technology, become "locked into" a fiat standard.[11] What's more, customary law, far from supplying a means for overcoming "lock in," tends to reinforce it, by recognizing and legitimizing established practice, even when that practice has itself been shaped by legislation rather than by mercantile custom alone. As Hayek (1982: 88) observes, the development of customary law "may lead to an impasse from which it cannot extricate itself by its own forces. . . . The development of case law is in some respects a one-way street: when it has already moved a considerable distance in one direction, it often cannot retrace its steps when some implications of earlier decisions are seen to be clearly undesirable."

Before World War I, in contrast, network effects favored gold itself. Although government intervention was proximately responsible both for the rise of bimetallism and for its eventual abandonment

[11]Although White (2012: 415) allows that the lock-in effect can be overcome by a sufficiently "painful period of high and uncertain inflation," thereby appearing to acknowledge the plausibility of Reisman's scenario for a spontaneous return to gold plausible, he fails to point out that even in that case currency substitution would tend to favor not gold but other relatively stable fiat currencies with substantial user networks. Gold's adoption might then have to await the prior destruction, through inflation, not just of one but of numerous established fiat currencies—a prospect as remote as it is terrible.

in favor of gold monometallism, as the size of the gold standard network increased, economic considerations alone encouraged governments and private traders alike to take part in it. Private law, in turn, recognized the fact that monetary units once representing silver had come instead to represent gold.

It should go without saying that these observations hardly serve to justify legal tender laws and other legislation aimed at propping up fiat monies by erecting barriers against the voluntary adoption of gold and other alternatives. They are aimed solely at showing why the elimination of such barriers alone is unlikely to result in any spontaneous gold standard revival. What's more, even if a new monetary standard were able somehow to overcome the network effects favoring established fiat monies, there is no reason for assuming that the new standard would be based on gold rather than some different, and perhaps as yet untried, exchange medium.[12]

## The Legislative Alternative

The understanding that a spontaneous gold standard revival is unlikely has led some who favor a return to the gold standard to rest their hopes instead on legislation aimed at directly securing that end. "The network property of a monetary standard," White (2012: 414–15) observes, "supports the case for not simply legalizing a parallel standard, but reestablishing a gold definition for the U.S. dollar." This means "converting the Federal Reserve System's liabilities and the Treasury's coins into gold-redeemable claims at so many grams of gold per dollar or equivalently so many dollars per ounce of gold" (ibid.: 412).

The practical shortcoming of such a step is that it would result not in a gold standard of the traditional sort but rather in a gold standard involving paper claims which, instead of being so many binding contracts, are convertible into fixed quantities of gold as a matter of public policy only. That the commitment in question, like any central-bank based exchange rate peg, might be reneged upon with impunity, would soon cause it to become the target of speculative attacks, and all the more so in light of the fate of previous, central-bank based gold commitments. As Obstfeld and Rogoff (1995: 73)

[12]At present, for example, though its use network is miniscule in comparison with that of most fiat currencies, bitcoin is far more commonly accepted than gold in U.S. retail payments.

observe, "Stuffing the genie of floating exchange rates back into its bottle is . . . easier said than done," with most efforts to do so ending "in spectacular debacles." They conclude that "for most countries it is folly to try to recapture the lost innocence of fixed exchange rates" (ibid.: 74). There is no reason to suppose that a government-sponsored revival of the gold standard of the sort White proposes would not prove another such folly.[13]

It is in part owing to the inherent weaknesses of a legislation-based gold standard that Timberlake and Reisman, among other gold-standard proponents, have staked their hopes on a spontaneous gold standard revival. "Sound money advocates," Timberlake (1995) writes, "should not waste their resources lobbying for a gold standard, which by definition would include the state as overseer and manager of a gold currency, specifier of a gold price in terms of dollars, custodian of the gold, and continuing manipulator of a central bank-issued paper money." And it is well to recall in this connection Friedman's own strictures upon the sort of legislative revival here being considered:

> This kind of pseudo gold standard violates fundamental liberal principles in two major respects. First, it involves price fixing by government. It has always been a mystery to me how so many who oppose on principle government price fixing of all other commodities can yet approve it for this one. Second, and no less important, it involves granting discretionary authority to a small number of men over matters of the greatest importance; to the central bankers or Treasury officials who must manage the pseudo gold standard. This means the rule of men instead of law, violating one of our fundamental political tenets. Here again, I have been amazed how so many who

[13]Although a gold-based Currency Board would be far more secure than a central-bank gold peg, it would also be extremely expensive. The very high gold parity obtained by dividing the M1 money stock by the available stock of gold would imply "a large influx of gold from the rest of the world, a large loss of U.S. wealth in exchange, and a sharp transitional U.S. inflation (White 2012: 417). This is true even assuming, as White does, that official gold stock numbers are valid. Moreover, even a 100-percent reserve or currency-board based gold standard could survive only for as long as it takes legislators to determine to alter it on the grounds that doing so has become expedient. According to Obstfeld and Rogoff (1995: 90–91), "The question is whether [monetary authorities] have the will to use their reserves if necessary: attacks need not be deterred unless the currency's 100 percent reserve backing is 100 percent credible."

> oppose on principle the grant of wide discretionary authority to governmental officials are anxious to see such authority granted to central bankers. . . . [S]ince when have we liberals tempered our fear of concentrated power by trust in the particular men who happen at a particular moment to exercise it? Surely our cry has been very different—that benevolent or not, tyranny is tyranny and the only sure defense of freedom is the dispersal of power [Friedman 1961: 78].

The Hayekian perspective taken here prompts me to embellish upon Friedman's point by observing that, the popular belief to the contrary notwithstanding, a gold standard consisting of a particular monetary rule to be implemented by government authorities, even if it awards citizens the opportunity to exchange paper currency for gold coin, is *not* an instance of the rule of law applied to a nation's monetary affairs. For a true application of the rule of law would place those affairs on the much firmer foundation of binding contracts and, hence, of customary law, which in turns means doing away altogether with public and quasi-public (or "government sponsored") monetary authorities.

## Conclusion

Our understanding of the legal foundations upon which a durable gold standard must rest, together with a consideration of both the legal and the economic forces that render the spontaneous revival of a gold standard unlikely, leads us straight into the horns of a dilemma, to wit: that while a spontaneous gold standard revival is extremely unlikely, a deliberate revival, involving the redefinition of existing dollar notes and credit, cannot be expected to last.

This conclusion is a sobering one to convey to those readers who would like to see the gold standard resurrected so as to recreate the exchange-rate and purchasing-power stability with which the classical gold standard was associated, and for which it was responsible. Nor is it any less so for being based upon the insights of a thinker who was himself one of the gold standard's more prominent champions. Economics has long been known as the dismal science, albeit for very bad reasons.[14] There are, alas, also good ones.

[14] The expression, as is now well known, was coined by Thomas Carlyle in the course of arguing for the revival of slavery.

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