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The Gold Standard: Myths and Lies

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With various states debating measures to elevate the monetary status of gold, the gold standard is more politically relevant now than it has been in decades. When the LA Times ^[2] (to pick just one example) runs an article stating matter-of-factly that "economists" uniformly oppose gold, you know the defenders of the current system are getting nervous.

Precisely because a gold standard is such a hot topic lately, it's important for people to understand its rationale. In the present article I'll try to clear up a few misconceptions.

Do All Economists Oppose the Gold Standard?

I realize I am betraying my naïvete by admitting this, but I was very surprised at the depth of falsehood in the LA Times ^[2] article mentioned above. Here is the blurb below the title, "Pushing for a Return to the Gold Standard":

The idea to make the precious metal legal tender has gained currency in more than a dozen state capitals, aided by Tea Party support and other efforts to rein in federal power. Economists say the plan would be disastrous.

I suppose the final sentence is technically true, but it's very misleading. It's a bit like saying, "Baskin-Robbins offers 31 flavors, but customers buy chocolate." Yes, *some* economists say a return to the gold standard would be disastrous, and I'd grant that perhaps even *a large majority* do. But the blurb above makes it sound as if *virtually all* economists oppose the move, which isn't true.

The writer, Nathaniel Popper, reinforces this misconception in two other places. He quite clearly tries to pit the rube businessmen and tea-party politicians against the professional economists. First he writes,

The ultimate goal is to return the nation to the gold standard, in which every dollar would be backed by a fixed amount of the precious metal. *Economists of all stripes* say the plan would be ruinous, but that view is of scant concern to Pitts [a South Carolina state representative].

"Quite frankly, I think that economists from universities are thinking within the confines of their own little world," Pitts said. "They don't deal with the real issues." (emphasis added)

Just to make sure the reader gets the point, Popper writes later in the article:

The United States and most of the rest of the world operated on a full gold standard until the Great Depression. Economists generally agree that the policy helped cause the depression and earlier severe downturns by limiting the amount of money the government could create, constraining its ability to stimulate the economy.

Scholars say moving to a gold standard now would be likely to slow the economy's already meager growth.

"At some point someone may be crazy enough to try it, but they won't stay with it anymore than they did in the past," said Allan Meltzer, a Carnegie Mellon University economics professor and a critic of the Fed's current monetary policy.

Given the lack of support from mainstream economists, activists have turned a few texts written by outsiders into their bibles, such as "[Pieces of Eight](#) ^[3]," an out-of-print book by [constitutional lawyer] Vieira.

In the entire article, Popper doesn't quote a *single* economist who is in favor of the gold standard, or even paraphrase his or her views. This might be acceptable, except for the fact that Popper quotes or makes reference to businessmen, politicians, and the lawyer Vieira. (I am not familiar with Vieira's work, and it should go without saying that I'm not criticizing him.)

Now, it would be easy for me to accuse Popper of lying, but for all I know he was so sure of the stupidity of the gold standard that he didn't even try to find actual PhD economists currently teaching at colleges (some even at top-20 graduate schools) who would have nice things to say about the gold standard. I personally know at least 20 such people, so believe me, they're out there if Popper or other journalists actually want to give the case for gold a fighting chance.

As far as books touting the advantages of the gold standard, yes indeed there are volumes written by people with PhDs in economics. A classic text is Ludwig von Mises's [The Theory of Money and Credit](#) ^[4], while a newer, much more reader-friendly selection is Murray Rothbard's [What Has Government Done to Our Money](#) ^[5]? My own [book on the Great Depression](#) ^[6] exploded the myth that the gold standard had something to do with it.

Did Gold Cause the Great Depression?

Before moving on, let me quickly address that particular claim. I've written a [longer response here](#) ^[7], but for now we have to wonder: If the gold standard caused the Great Depression, what else was going on? After all, the gold standard wasn't *implemented* in the 1920s. Although there had been plenty of industrial crises or financial panics in the previous hundred years, there had been no prolonged global depression approaching the experience of the 1930s — even as more and more countries joined the growing worldwide market of gold-based economies. So clearly it's not enough to point to the "golden fetters" of the monetary system to explain what happened in the Great Depression.

Thus, to blame the Great Depression on the gold standard is just as nonsensical as blaming it on the "laissez-faire" policies of [Herbert Hoover](#) ^[8], who (even if we take the caricature of him seriously) was no different from all his predecessors. It would be like explaining a particular airplane crash by citing gravity.

As a final point, let's not forget that FDR abandoned the gold standard *in 1933*. The Great Depression thus lingered on — *after* leaving the allegedly awful gold standard — for at least another 8 years (and I would say 13 years, because I don't think World War II "fixed" the

economy), in what was still the worst economic period in US history. It's odd that the gold standard could wreak so much havoc in the early 1930s — even though it had never done anything comparable earlier in US history — and then could continue to "cause" the Great Depression, from 8 to 13 years after abandoning it. It starts to make you wonder whether the "economists of all stripes" know what they're talking about.

"You Can't Eat Gold!"

One of the most absurd objections to returning to a gold standard is that "You can't eat gold." I am not making this up; Dave Leonhardt of the *New York Times* actually said that to Ron Paul when he defended the idea on the Colbert Report ^[9].

Dr. Paul didn't really get a chance to answer (Colbert instead made a funny joke about idolatry), but it would have been delicious had he quickly asked the cynic, "Oh, so you make sandwiches out of Federal Reserve notes?" (We also would have accepted, "Oh, so I take it you are proposing a hamburger standard for the dollar?")

The utter absurdity of the objection — namely that you "can't eat gold" — is that gold actually *is* a useful commodity even for nonmonetary purposes. It's true, you can't eat gold, but you can wear it ^[10], you can fill cavities ^[11] with it, and you can treat arthritis ^[12] with it. In contrast, *all* you can do with fiat paper currency is use it in exchange, and you'd better not keep a large fraction of your wealth in actual paper dollars, since their purchasing power constantly erodes with the passage of time.

Don't Austrians Favor Market Choice?

Ironically, in addition to ill-informed critiques such as those emanating from the *LA Times*, the gold standard has critics from the purist libertarian camp. Such critics often ask, "What's so special about gold? Why do Ron Paul and so many other alleged fans of the free market favor the federal government telling us what the money should be?"

Of *course* Murray Rothbard — and as far as I know, every living Austrian economist — would prefer that money and banking were returned to the private sector, receiving neither special regulations nor privileges distinguishing them from any other industry. That means banks would be free to issue their own paper notes (backed by gold reserves) if they wanted, but if they issued too many and got caught in a "run," the government wouldn't declare a "bank holiday" and relieve the irresponsible institution of its contractual obligations.

"There is a whole tradition of excellent academic scholarship touting the virtues of the gold standard."

What Rothbard and his modern followers believe is that gold almost certainly would be the *free choice* of individuals all over the world, if they were allowed to settle on a money without government legal-tender laws and other interventions stacking the deck.

In the meantime, given that there is a Federal Reserve (and other central banks), many Austrians (though here the agreement is not universal) believe that restoring the convertibility of the dollar to a fixed weight of gold would be a move in the right direction, even though it would still not be perfect.

The purpose of repegging the dollar to gold would be to remove what is euphemistically called "monetary policy" (a more sinister description would be "legalized counterfeiting" ^[13]) from politics and special-interest corruption as much as possible. People laud the *current* Fed as being "independent," but of course that is absurd. The Fed as it currently operates is clearly a cartelization device that shoves new money into the pockets of rich bankers, and that allows the government to finance massive deficits much more cheaply than would otherwise be possible.

"So You Want the Government to Set Prices?"

Related to the above criticism, some purists also ask, "Why don't you favor a market-driven price for the dollar and for gold? Just let supply and demand determine prices, not some rigid number picked out of a hat by the politicians."

This objection sounds plausible at first, but it too misses the mark. If the Fed were to say, "We are now announcing a new policy objective of maintaining the price of gold at \$2,000 per ounce, from now until the end of time, and we will begin accumulating stockpiles of gold to reassure investors that we will be able to maintain the target," this would *not* be analogous to the federal government saying, "We are establishing a minimum price of labor at \$7.25 per hour."

Under a genuine gold standard, when the Fed "sets" the dollar price of gold it isn't threatening people with fines or jail time if they want to trade gold at a different price. Rather, the Fed (or the government in general, if there were no central bank) would adjust the *quantity of dollars in existence* to maintain the target. If the forces of supply and demand were such that the market price of gold had drifted upward to, say, \$2,025 per ounce, then the Fed (assuming a \$2,000 target) would need to sell off some of its gold holdings,¹ which would (1) flood the market with more gold and (2) shrink the amount of dollars in the financial system. This contractionary policy would push down the price of gold toward the peg of \$2,000.

"Under a genuine gold standard, when the Fed 'sets' the dollar-price of gold it isn't threatening people with fines or jail time if they want to trade gold at a different price."

On the other hand, nobody would be so foolish as to sell his gold for *less* than \$2,000 per ounce, if the Fed (or the Treasury) had a standing invitation for anyone to trade in an ounce of gold in exchange for \$2,000 in Federal Reserve notes. Why sell your gold to another private citizen for (say) \$1,950 an ounce, when the US government stands prepared to buy unlimited quantities of gold at a fixed price of \$2,000 per ounce?

Finally, a critic could (and actually did, on my blog) ask how this arrangement differs from the current one? After all, right now Bernanke "sets" interest rates, but not through literal price controls. Instead, the Fed adjusts the quantity of reserves in the banking sector such that the "market-determined" federal funds rate is close enough to the Fed's target for this interest rate. So isn't this basically the same thing as the gold standard, with a different "good" serving as the monetary commodity?

There are two problems with this sophisticated objection. First, in the current system the Fed has a *moving* federal-funds target. At best, then, it would be analogous only if the Federal Open Market Committee said after each meeting, "We are now setting the target price of gold at such-and-such dollars. However, if unemployment begins rising and core CPI is under 2 percent, we will begin raising the target price of gold in \$10 increments over the next few meetings." *That* system would be nothing like the classical gold standard.

Yet the deeper problem with the analogy is that on a classical gold standard, the government is (imperfectly) mimicking what would happen if the money were *actually* gold, with people walking around with gold coins in their pockets, and merchants quoting prices not in dollars but in grains or ounces of gold. The classical gold standard, by fixing the dollar as convertible into a definite and constant weight of gold, doesn't introduce another price: the dollar is supposed to be a claim-ticket to gold. This isn't really "price fixing," any more than defining a foot as 12 inches is "central planning."

In contrast, what would be the free-market analog of the Fed's current strategy of targeting short-term interest rates? The only thing I can think of is if the money commodity in a community weren't something tangible like gold, silver, or tobacco, but rather overnight bonds issued by banks. Yet what is a bond but a promise to deliver *money*? So how could the money itself be a short-term bond? At this point I am dropping the analogy, lest I become permanently cross-eyed.

Conclusion

As the Fed's debasement of the currency reaches literally unprecedented levels, more and more regular Americans are waking up to the merits of commodity money. Yet this isn't some populist fad; there is a whole tradition of excellent academic scholarship touting the virtues of the gold standard. If he returns to the subject, I hope critics like the *LA Times's* Popper will give gold a fairer hearing.

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1. The operation would be automatic if the system were set up along the lines of the classical gold standard. People all over the world would have the guarantee that they could always turn over \$2,000 in Federal Reserve notes in exchange for a physical ounce of gold. If the market price of gold ever went above \$2,000, therefore, speculators could earn arbitrage profits by buying from Uncle Sam at \$2,000 and reselling gold in the market for more.

Austrian School: Gold Standard ^[15]

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- [2] <http://articles.latimes.com/2011/jun/03/business/la-fi-gold-standard-20110603>
- [3] <http://books.google.com/books?id=NPsvAQAAIAAJ>
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- [7] <http://mises.org/daily/3778/The-Gold-Standard-and-the-Great-Depression>
- [8] <http://mises.org/daily/5215/Is-Budget-Austerity-Modern-Day-Hooverism>
- [9] <http://www.youtube.com/watch?v=oNIOGQveWmE>
- [10] <http://en.wikipedia.org/wiki/File:NancyReaganMrTChristmas1983.jpg>
- [11] <http://www.webmd.com/oral-health/guide/dental-health-fillings>
- [12] <http://www.orthop.washington.edu/PatientCare/OurServices/Arthritis/Articles/GoldTreatment.aspx>
- [13] <http://mises.org/daily/4029/The-Fed-as-Giant-Counterfeiter>
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