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15 The Image of the Gold Standard

Leland B. Yeager

15.1 The Gold Standard from the Viewpoint of Prospective Adherents

Bills were pending in the parliaments of Austria and Hungary in 1892 to put those countries on the gold standard. In Austria, Deputy Anton Menger, a lawyer and brother of the economist Carl Menger, was chosen to sum up the pro-gold-standard position at certain stages of the debates. Anton Menger tried to refute the objection of the critics that gold, like the paper gulden, could be unstable in value—perhaps even more unstable. His economist brother, although also in favor of the gold standard, recognized that it had some "undeniable disadvantages," including the instability in the value of gold and especially its rise in value in recent decades. The paper gulden, he recognized, had been satisfactorily stable in value for domestic business (Menger 1936, p. 123).[1] By the value of gold and value of the gulden, Carl Menger, as well as the actual critics of the gold standard, clearly meant purchasing power.

Anton Menger evidently did not understand this. He suffered not merely from a money illusion but from a pound-sterling illusion specifically. Anyone can see how stable gold has been, he told critics, if they would take the trouble to look at a statistical table of its price on the London market from 1878 to 1891. He conceded that some fluctuations had occurred.

> Do you know how large these were? The greatest change amounted to 0.13 per cent. What a difference? In one year our money notes have changed in money-value by about ten per cent, while gold, over the course of a period of 12 to 13 years, has changed only by 0.13 per cent.

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> Under such circumstances there is no doubt at all that there can be no question at all of comparing banknotes with gold in regard to the function of measure of value. (Austria, Parliament, Chamber of Deputies 1892, p. 7182)[2]

Evidently, then, the economic understanding of his brother Carl had not automatically rubbed off onto Deputy Anton Menger.

I thought I might say something tonight about the image of the gold standard in the late nineteenth century. I'll look at it from the standpoint of legislators, economists,[3] and pamphleteers in countries that were contemplating a move onto gold, namely, Austria-Hungary and Russia. These countries had fiat paper moneys, having been inflated off of their traditional silver standards several decades earlier by paper-money issues to cover the expenses of wars and revolutions.

15.2 Arguments Pro and Con

Automatic regulation of the money supply was one of the advantages most strongly argued in Austria in favor of the gold standard. In countries with a sound monetary system, Carl Menger explained, money flows out if commodity prices rise and in if prices fall appreciably in relation to their normal level. It was a defect of Austria's isolated monetary system that flows of money and gold could not fill temporary gaps in the balance of payments, so that balance had to be maintained entirely in goods and securities. Domestic business suffered because its changing needs for money confronted an inadequately elastic paper-money supply. "We lack the mechanically operating, regulating influence of the inflow of money onto our markets; for this reason, we have apathetic, insensitive commodity markets; prices in Austria are not calculated precisely, as in England or Holland; we have apathetic markets, which paralyzes the spirit of enterprise" (Menger 1936, p. 294).[4]

Carl Menger recognized that the typical European currency was not a gold currency but a "gold-plated" one. It had a core of paper, surrounded by layers of minor coins and silver and then with an outer layer of gold plating. This arrangement was good enough for him, provided the plating was strong enough to resist the acid test of financial crisis. What he wanted was stable exchange rates (p. 247).

In Hungary, István Tisza expressed similar ideas: A paper-money country experiences no significant inflows and outflows of money. "In gold-standard countries, on the other hand, the size of the need for gold is decisive." Rich or populous countries need more media of exchange, poor or less populous ones need less.

> The relation between quantity and need must be such that in both places they are equal; and money even goes from the richest country to

> the poorest if there is relatively greater need for it there, for then it can be turned to better account there; and the elements of the balance of payments will necessarily change as the relation between the quantity of and need for gold requires. . . . The tendency of balances of payments will always be . . . to equalize the relation between demand and supply in all countries and give all as much gold as they need in relation to the needs of others. (Tisza 1890, pp. 92–93)

Its Austrian supporters saw the gold standard less as a transmitter of foreign disturbances than as a means of cushioning domestic disturbances by linkage with the presumably more stable world economy. Franz Perl wrote in 1887 that

> in the isolation in which our currency places us, we are left to our own resources whenever credit is shaken; that international flow of money which stands helpfully at the side of other money markets in times of need is lacking to us; our securities, which only in rare cases have a real abode abroad, return to us at the least sign of mistrust; we lack that equilibrating help. (Perl 1887, p. 64, citing Alfred von Lindheim)

Deputy Anton Menger also believed that business crises were "very considerably intensified" by the inability of money to flow into and out of Austria, a monetary island. The value of Austrian money rested only on a very dangerous basis, its scarcity, for a country should have enough money and not too little (Austria, Parliament, Chamber of Deputies 1892, pp. 7182–83).

Another deputy (Eim) pointed out that the value of a paper money depended on the need for money and on the amount in circulation. The latter could be controlled, but the need for money could hardly be calculated. Thus, the value of paper money "is subject to continual changes, which depend on the most various circumstances, often on chance, indeed even on speculation (p. 6989).

The economist Julius Landesberger likewise saw it as a grave defect of a system of purely fiduciary money that it could not work well "unless it were continuously possible to ascertain most reliably the need of the whole economy for means of circulation at all times and to regulate the monetary circulation correspondingly. To this, however, the resources of science are not adequate today" (Landesberger 1892, p. 68).[5]

Russian supporters of gold also argued that that standard made a country's money supply appropriately elastic. Under a paper system, by contrast, the money supply supposedly did not respond appropriately and automatically to the changing need for means of circulation; yet it was impossible to calculate and deliberately meet that need. In a gold-standard country, though, a deficiency of the domestic money supply would remedy itself through a balance-of-payments surplus and an inflow

of gold, and a superabundance of money would remedy itself through a deficit and an outflow. Each country would automatically come to hold the quantity of metallic money appropriate to its wealth and transactions, without anyone's having to try to estimate the required quantity.[6]

Opponents of the gold standard sometimes argued that the sacrifices required to get onto gold would prove to have been in vain in case Austria-Hungary should get into another war. The progold reply was that the country should have hard money in peacetime to save the possibility of paper-money issues—the state's "note credit"—for wartime. With the country having a depreciated paper money even in time of peace, said Perl (1887, p. 29), every economist and patriot must shudder to think of what would happen in time of war or fear of war.

In Russia, also, gold standard opponents argued that monetary reform would not be worth the trouble, since a new war would only make the paper money irredeemable again. The reply was that irredeemable paper money should be abolished now so that new issues could be put into circulation if the occasion arose. The currency reform could be a "reconstruction of war material" (Schultze-Gävernitz 1899, p. 462). Starting from the gold standard, the government would have better wartime financial alternatives than if it started from irredeemability.

Early in 1879, when the world-market price of silver had sunk so low that the Austrian gulden was again worth as much as its supposed silver content, or even slightly more, the coinage of silver on private account threatened to inflate the money supply and price level. The Austrian and Hungarian governments responded by closing their mints to the free coinage of silver. That action had been taken in a legally very informal way, however, leaving the possibility that the silver standard would come alive again. For some years the gulden floated at a value above that of its supposed silver content.

By 1890, a different aspect of the loose link remaining between the gulden and silver—one working through speculation about domestic redemption and coinage policy and American silver-purchase policy—came to the fore, providing one of the strongest motives to reform. The Austrian financial press and Parliament seemed preoccupied with the progress of the Sherman Silver Purchase Bill in the U.S. Congress, and unusual day-to-day jumps in the price of silver and the gulden's exchange rate were generally attributed to news from Washington.

Finance Minister Steinbach warned Parliament on 14 May 1892 that forces supporting and opposing free coinage of silver in the United States were almost evenly balanced; powerful influences on the Austrian currency *could* come from that direction. "*The rate fluctuations of the year 1890*, which you all remember, gentlemen, have brought us a *small foretaste* of what would happen if silver coinage were made free today in

the United States of North America" (Austria, Parliament, Chamber of Deputies 1892, p. 5930).

Another aspect of legal untidiness was the existence of four distinct types or concepts of gulden: (1) the ordinary fiat gulden ("gulden of Austrian currency"), in which currency and bank deposits were denominated and in which most prices and debts were expressed; (2) the silver gulden, in which some bonds and preferred stocks were still denominated and which could again become separated from the ordinary gulden if silver rose sufficiently in market value; (3) a gold gulden worth two-and-a-half French francs, in which some bonds and customs payments were expressed; and (4) another gold gulden, worth 1.2 percent less, which had some slight application in government accounting; it was the gold equivalent of the standard silver gulden at the 15.5:1 bimetallic ratio of the Latin Monetary Union. As Josef Kreibig later observed, "if there was one drastic proof of the necessity of a reform, it was this peculiar splitting of the monetary unit" (Kreibig 1899, pp. 61–62).

15.3 Climates of Opinion

Dominant Hungarian interests switched in favor of gold around 1889–90. Earlier they had opposed it out of fear that it meant appreciation of the paper gulden to equality with the two-and-a-half-franc gold gulden, hampering agricultural exports. But as the Hungarians came to realize that the gulden would not be pegged upward at that rate and that the gold standard might mean resistance to further appreciation, or even a partial reversal of recent appreciation, the sentiment of the country's export- and import-competing interests shifted.[7]

It seems that the experts, so considered by the Establishment, were almost all in favor of the gold standard. Being an expert (and so being invited to testify before the commissions mentioned in footnote 3) apparently presupposed, almost by definition, advocacy of the gold standard. None of the major Austrian political parties, as a party, opposed the gold standard, although many individual deputies did. Even proponents of the gold standard recognized that a large opposition existed—and that opponents might possibly outnumber proponents—but outside the most influential circles. The masses had supposedly become accustomed to the existing currency situation and were apathetic about reform. Among the articulate, though, advocacy of gold dominated. A propaper pamphleteer suggested a version of the fable of the emperor's clothes: even people who did not understand the supposed disadvantages of paper money and the supposed advantages of gold nevertheless joined the progold chorus in order not to seem unenlightened (Gruber 1892, pp. 114–15).

Even so, opposition consumed most of the time in the parliamentary debates. This was understandable: the government's position took the form of definite bills, and only so much could be said in their favor without repetition, while opposition views were aired in great variety. Only a minority of the opponents forthrightly favored retaining fiat paper money. Most of them wanted bimetallism, or thought that the time was not ripe for the gold standard, or believed that action should await some sort of international agreement, or wanted a gold standard different from what the government's bills would introduce, or engaged in nit-picking about such issues as the emperor's titles on the new gold coins. The only amendment adopted was one expanding his titles from Imperator et Rex to a long list including King of Bohemia, King of Gallicia, and ending with Apostolic King of Hungary.

Some pamphleteers did state the case for retaining a fiat paper money with floating exchange rates—a case centered around the greater importance of domestic than of exchange-rate stability and the importance of a measure of insulation from foreign deflation and crises. Josef Neupauer predicted that "a slow and steady increase in the means of circulation will without doubt encourage the spirit of enterprise, and all the more remain without influence on the price of the Austrian money as indeed the population grows and the whole economy develops." He proposed that the new money necessary to accompany real economic growth be put into circulation through purchase of securities on the Bourse. He even hazarded a guess about the proper rate of annual increase in the money supply—4 percent (Neupauer 1892, p. 26 and *passim*).

Dominant trends of opinion were apparently quite different in Russia. The discussions of the Imperial Free Economic Society in St. Petersburg in March–April 1896 (cited in note 3) serve as evidence that advocacy of the gold standard was *not* part of the conventional wisdom among economists and leading thinkers. Even advocates of the gold standard acknowledged that apathy toward the reform was quite general. Schulze-Gävernitz referred to those discussions to justify his assertion that "the State carried out the currency reform *against* public opinion, with few exceptions, *against* the press, *against* the tough resistance of the public" (Schulze-Gävernitz 1899, pp. 461–62, 470–71).

Finance Minister Sergei Witte also testified to the climate of opinion. As he said, nearly the whole of thinking Russia was initially opposed to his reform. Even he, while new in office, contemplated abandoning his predecessors' work of moving toward the gold standard.[8]

The opposition to the gold standard was so strong in Russia that in order to enact it, the Tsar had to bypass the usual legislative procedure, which involved various committees. Supporting his finance minister, the Tsar enacted it piecemeal by autocratic decrees.[9]

15.4 Noneconomic Motives

Before turning to the noneconomic reasons for adoption of the gold standard, particularly in Austria, I want to emphasize that the economic reasons did *not* include poor performance of the fiat paper currency (see Yeager 1969, pp. 61–89). Exchange-rate fluctuations were not extreme by present-day standards, and the paper currency was not suffering price inflation. (In fact, the price trend had been downward since about 1871, though less steeply downward than in the gold standard world.)

Yet Deputy Anton Menger complained. He said that importers and exporters were able to perceive seasonal tendencies in the exchange rate—very feeble tendencies, so far as the figures show—and profit from them by shrewdly timing their purchases and sales of foreign exchange. This sounds like stabilizing speculation to us—hardly grounds for complaint. Yet Menger implied, without articulating his complaint explicitly, that the gains of the shrewd traders were necessarily coming at the expense of the country as a whole (Austria, Parliament, Chamber of Deputies 1892, p. 7473). The gold standard would put a stop to that.

Apart from the economics of the matter, the fluctuating exchange rate was widely viewed as a symbol of disorder and backwardness, whereas being on the gold standard—the most *modern* monetary system—was the mark of a civilized country. Vienna's leading newspaper deplored the monarchy's confused monetary system—with silver as the basic metal, with irredeemable paper notes in circulation, and with the gulden's value exposed to the vicissitudes of wild international speculation—"while all civilized states have long since assured themselves of a stable measure of value, a money as steady in value as possible" (*Neue Freie Presse*, 7 September 1890).[10]

Considerations of prestige were at work. In the Hungarian Currency Inquiry of 1892, Koloman Szell, a former finance minister and future prime minister, declaimed about "the stigma of a paper economy, unworthy of a civilized nation" (quoted in Gruber 1892, p. 117). The Currency Committee of the Austrian Parliament observed in 1892 that "considerations of state [had] influenced the decision of the government" to proceed with gold-standard legislation. Twenty years before, Austria had not been alone in using paper money; since then the United States, Italy, and even little Rumania had gone onto the gold standard. Russia, the only other major power still with a paper standard, was already making preparations for going onto gold. "Every year it detracts more from the State prestige of Austria that it still belongs to the countries with an unregulated currency" (Austria, Parliament, Chamber of Deputies 1892, *Beilage* no. 491, p. 8).

Deputy Dr. Foregger reminded his colleagues that the "scrap-of-paper

economy" degraded Austria economically to a second-rate power. "We demonstrate that our Empire does not have the strength to introduce among us, too, the means of payment, hard money, that holds sway in the civilized world. We thereby incessantly damage our credit, our economic flexibility and competitiveness." Lack of foreign confidence extended beyond the economic sphere into

> all other sides of our international relations; it lessens respect for us, esteem for us; it lessens our power position. We must therefore make all efforts to bring the strength of our Monarchy into full effect again by regulating our monetary system. . . . We cannot have a separate, an insular, currency continue: if we want to take part in the competition of civilized nations, we too must accept the international means of payment, and the international measure of value is just nowadays gold. (Pp. 7132–33)

The "scrap of paper" to which Dr. Foregger alluded was itself a source of dismay. The state currency notes (as distinguished from the notes of the Austro-Hungarian Bank) were thought of as an actual debt to be paid off sooner or later. This view found support not only in linkage of the legally permissible quantities of state notes and treasury bills (*Salinenscheine*) under a ceiling on their combined amount but also in the inscription on the notes themselves, which acknowledged each note as "a part of the common floating debt of the Austro-Hungarian Monarchy" ("common" here meaning shared by the two governments). The term "floating debt" sounds more ominous in German than in English—*schwebende Schuld*—conveying the impression of a "hovering guilt" still to be expiated. One of the purposes of the monetary reform bills of 1892, the Austrian government said, was to abolish these state notes, which had been issued under the compulsion of "shattering political events" (Austria, Parliament, Chamber of Deputies, *Beilage* no. 436). The reference was to monetary inflation during the Austro-Prussian War of 1866. The yearning to banish an ever-present reminder of the humiliation of Königgrätz was an old one. On 1 November 1884 the *Neue Freie Presse* said that "redeeming the floating debt" was "an old duty of honor of Austria." On 1 January 1892 the newspaper lamented "the dismal legacy of revolution and wars, the irredeemable notes, these hateful stains on the name of Austria. . . . The paper gulden is . . . [a] sad monument that has been erected in our budget to remind us of the sufferings of the past."

Even the analytical Carl Menger "most decidedly" rejected "the opinion of those who deny Austria-Hungary the right to reshape her currency on the pattern of that of the civilized nations. It should not be interpreted as immodesty if we too wish to be counted among the 'nations les plus avancées dans la civilisation,' among the nations that are already 'ready for gold,' and not among the peoples 'of the other currency area,' which

should content themselves with silver currency" (Menger 1936, pp. 172–73).

Among its advocates in Russia, the gold standard "had become, in the midnineties, more than ever a matter of national respectability and economic advantage. . . . For Russia (as for any civilized country at that time) it was a prerequisite for sound credit and economic progress in general. Above all it would encourage more foreign investment in Russian industry" (Von Laue 1963, p. 139).

A. N. Gurjev was one of the economists who held such a view. For him, restoration of the ruble to a metallic basis had political and cultural as well as economic significance:

> Membership in worldwide civilization is unthinkable without membership in the worldwide monetary economy. . . . A country with an isolated monetary economy cannot enter into stable cultural intercourse if it is separated from civilized peoples by the whole complex of economic evils connected with the disorder of the monetary system (Gurjev 1896, p. 163).

Finally, we have the judgment of an eminent Austrian economist of a later generation. Modern economists will be quite unable to understand, said Joseph Schumpeter, why countries such as Austria-Hungary, Russia, and Italy imposed hardships on themselves to adopt gold parities for their currencies. No important economic interests clamored for that policy. Noneconomic considerations were decisive. Gold symbolized sound practice and honor and decency. "Perhaps this explanation raises more problems than it solves. That it is true is certain" (Schumpeter 1954, p. 770).

15.5 Some Reflections about This Conference

Now I'll make a sharp change of course. Toward the end of my talk I'll return to the theme of the image of the gold standard.

When Professor Michael Bordo invited me to speak this evening, he suggested that I might want to reflect on what we had learned from the conference papers and from the discussion. I was particularly glad to hear what Donald McCloskey and Richard Zecher have to say about purchasing-power parity. (I hasten to add that accepting purchasing-power parity does not necessarily imply accepting the extreme version of the monetary approach to the balance of payments, which identifies a balance-of-payments deficit with a process of working off an excess supply of money and identifies a surplus with a process of satisfying an excess demand for money.)

Purchasing-power parity is one of the few dependable generalizations that we have in economics. It is a generalization about the range within

which a floating exchange rate tends to fluctuate and about what relation has to hold between prices in different countries if a fixed exchange rate is to remain workable. Purchasing-power parity should not be understood to deny that other factors influence exchange rates or international price relations, including specific historical factors such as the "country risk" of investment in Italian securities that Michele Fratianni and Franco Spinelli spoke of.

Yet there seems to be a passion among more than a few economists to deny or question our most dependable generalizations, perhaps by interpreting them in so exaggerated and rigid a way that they are not strictly true. Other examples are the treatment often accorded to the quantity theory of money and the marginal-productivity theory of the demand for labor and other factors. Overeager critics need to be warned against what Thomas Sowell (1980, pp. 291–92, 324) calls the precisional fallacy.

I was glad to hear McCloskey and Zecher ask, when told about the failure of purchasing-power parity: Failure relative to what? Failure by what standards? Failure relative to what alternative theory? (Here I am embroidering a bit.) In dealing with their respective subject matters, what theories are more satisfactory than the quantity theory or purchasing-power parity or marginal-productivity theory? Do we really want to say that the price level (in a country with a floating exchange rate) depends on all sorts of influences, among which the quantity of money plays no distinctive role? Do we want to say that the floating exchange rate between two currencies depends on supply and demand, which reflect the influences of all sorts of actual and potential transactions, and that nothing more definite can be said? Would we want to say that no meaningful generalization can be offered about the relation between price levels in different countries under a regime of fixed exchange rates?

Agreed, all sorts of influences, some more and some less bound to specific historical circumstances, do affect a country's price level, the relation among different countries' price levels, and the ranges within which free exchange rates tend to fluctuate. But we are asking about theories—generalizations. What better generalizations are available to replace the quantity theory and the purchasing-power-parity doctrine? Unless one can answer that, talk about their "failure" is premature.

McCloskey and Zecher took some swipes at what they call closed-economy theorizing. I hope they do not mean that the acceptability of purchasing-power parity actually precludes any such theorizing. For at one stage of presenting monetary theory, it is useful and legitimate to assume a closed economy or what for the purpose at hand amounts to the same thing, namely, an economy with an independent currency and a floating exchange rate. We see why and how the supply of and demand for money affect nominal income and the price level.[11] The discussion prepares us for understanding the interrelations among money supply, money demand, and the balance of payments under fixed exchange rates.

I hope that accepting purchasing-power parity does not require us to assume that prices in each particular country under fixed exchange rates are simply dictated to it by the outside world. How, then, would the world price level be determined? How would gold discoveries under the gold standard affect world prices? It would seem odd to maintain that the money supply follows and responds to the externally dictated price level in each particular country, although the money supply leads and determines the price level in the world as a whole.

To repeat, closed-economy theorizing, or something closely akin to it, does have a legitimate place in explaining relations between money supplies and price levels. But open-economy theorizing is also necessary.

Some of the conference papers and commentaries have made me wonder whether there isn't too much polarization knocking around—too much discussion of possibly parallel or alternative economic processes or aspects of processes as if descriptions of them were the mutually contradictory assertions of rival theories. An example is the supposed rivalry between Hume's theory of price-level shifts, which would hold true in a case of slight substitutability between domestic and import and export goods, and the theory of Adam Smith and modern devotees of the monetary approach to the balance of payments regarding how the relation between money supply and money demand affects spending and the balance of payments directly, even apart from relative price shifts.

The monetary approach, sensibly interpreted, does not say (as Mordechai Kreinin and Lawrence Officer, quoted in Michele Fratianni and Franco Spinelli's paper, interpret it as saying) that the famous elasticities of the elasticity approach to balance-of-payments analysis are irrelevant. Rather, the extreme monetary approach, together with its related assertion that the law of one price holds strictly, carries certain implications about the elasticities: they are extremely high; goods are highly substitutable. In reality, of course, the law of one price does not hold strictly, and the elasticities are not extremely high; but contemplating the unreal polar case can still be instructive.

I also suspect polarization between supposedly rival theories in some of the "testing" we have seen for observance of the rules of the gold-standard game. As Fratianni and Spinelli say, an identification problem is involved: Are changes in the domestic component of the monetary base a response to or a cause of changes in the international component? Does causation run *from* or *to* domestic assets? Shouldn't distinctions be made between long-run and short-run behaviors with regard to rules of the game? I'd like to echo Heywood Fleisig's call for clearness about what disturbance is being supposed and about what is being taken as exogenous and endogenous.

I conjecture that differences among what may appear to be different theories—concerning, for example, Hume's price-specie mechanism, direct-spending effects, the law of one price, the direction of causality

between changes in domestic and international components of a country's monetary base, the direction of causality between price levels and exchange rates, and different mechanisms of balance-of-payments adjustment—do not so much indicate contradictions (to be settled by empirical research) as, rather, reflect different assumptions and different scenarios. The remedy for such apparent contradictions is to lay out the questions at issue precisely: What happens if such-and-such circumstances prevail and if such-and-such a disturbance occurs? When we bring historical facts and figures into a discussion about supposedly rival theories, we should try to be clear about what questions the facts and figures are meant to shed light on.

I suspect that some of the papers and comments at this conference have failed to distinguish sharply enough between (1) using economic theory as a tool of historical research—as an aid to gathering, sorting, organizing, and interpreting historical facts—and (2) appealing to history to discriminate between correct and incorrect economic theories. The facts underlying or informing economic theory "ought" to be more basic, dependable, and enduring and more firmly rooted in human nature and the human condition than the contingent facts of specific historical conditions and episodes. I am suspicious of looking to such contingent facts to settle basic theoretical issues.

15.6 The Seductive Appeal of the Gold Standard

Now, in preparation for coming to a conclusion, I want to return to my earlier themes. These themes concern the appeal or the desirability of the gold standard.

As we know, some prominent economists and politicians nowadays are recommending a return to the gold standard—or the adoption of whatever it is that they are marketing under that label. My response is not that we must not turn back the clock. That hackneyed slogan betrays a provincialism about one's own time, a shallow meliorism, a moral futurism. Nor is my message that we *can't* turn back the clock. Rather, my message is a reminder of *what it is* that we would have to turn back to. It is a reminder of the entire situation in which the gold standard flourished. More exactly, perhaps, the gold-standard world is an idealized past state of affairs.

The few, very few, decades during which the international gold standard flourished offered almost uniquely favorable conditions. Mint pars among gold standard currencies, instead of being arbitrarily chosen, expressed an equilibrium that had evolved gradually between themselves and national price levels. Mildly rising world prices after 1896 facilitated relative adjustments of prices and wages, while the uptrend did not last long enough—until war destroyed the system—to dissipate its possible

benefits by becoming embodied in expectations. Relative calm in social and political affairs and the absence of excessively ambitious government programs and excessive taxation all favored confidence in monetary stability. The age of the gold standard was an age of peace, relatively.[12]

Hugh Rockoff suggested that the tolerably good performance of the gold standard before World War I hinged on favorable conditions that no longer prevail: a corps of dedicated gold prospectors working in unexplored areas; absence of political interference (a laissez-faire atmosphere); patience with the long and uncertain lags in the response of the gold supply to the changing demand for money.

By and large, people (in countries that happened to be on the gold standard, anyway) were freer from government control than in any age before or since—freer to transact business, to make investments, to transfer funds, to travel. There is a certain charm in the reminiscences of an old German banker of how, during his student days at Heidelberg, he and some friends, one of whom had just come into an inheritance, left on the impulse of the moment for a tour of Italy, where the banker in the first town they stopped at considered it an honor to cash in gold coin the large check written by the young stranger. There is similar charm in Jules Verne's story of Phineas Fogg, who left on short notice for his eighty-day tour of the world, paying his expenses from a carpetbag full of Bank of England notes, accepted everywhere. The civility and internationality prevalent during the age of the gold standard have such charm for us nowadays that it seems almost sacrilege to ask whether these benefits resulted from the gold standard or, instead, coexisted with it by mere coincidence.

The gold standard, in short, evokes the "good old days." This association is well illustrated by two quotations, the first from Benjamin M. Anderson, a lifelong champion of gold, and the second from John Maynard Keynes, his generation's leading critic of that standard.

> Those who have an adult's recollection and an adult's understanding of the world which preceded the first World War look back upon it with a great nostalgia. There was a sense of security then which has never since existed. Progress was generally taken for granted. . . . We had had a prolonged period in which decade after decade had seen increasing political freedom, the progressive spread of democratic institutions, the steady lifting of the standard of life for the masses of men. . . .
>
> In financial matters the good faith of governments was taken for granted. . . . No country took pride in debasing its currency as a clever financial expedient. (Anderson 1949, pp. 3–4, 6)

> What an extraordinary episode in the economic progress of man that age was which came to an end in August, 1914! . . . [A]ny man of capacity or character at all exceeding the average [could escape from the working class] into the middle and upper classes, for whom life

> offered, at a low cost and with the least trouble, conveniences, comforts and amenities beyond the compass of the richest and most powerful monarchs of other ages. The inhabitant of London could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages. . . . He could secure forthwith . . . cheap and comfortable means of transit to any country or climate without passport or other formality, could despatch his servant to the neighboring office of a bank for such supply of the precious metals as might seem convenient, and could then proceed abroad to foreign quarters, without knowledge of their religion, language, or customs, bearing coined wealth upon his person, and would consider himself greatly aggrieved and much surprised at the least interference. But, most important of all, he regarded this state of affairs as normal, certain, and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous, and avoidable. (Keynes 1920, pp. 10–12)

Reminiscences like these reinforce my impression that the outbreak of World War I was a momentous turning point and a great tragedy in the history of the world—a tragedy all the more poignant because the war broke out so accidentally. The building in Sarajevo near which the assassin was standing when he fired the fateful shots bears a plaque saying that here, on 28 June 1914, Gavrilo Princip carried out an act expressing resistance to tyranny and the will to freedom. The inscription says nothing about the initiation of a chain of events that may, even yet, carry to the destruction of Western civilization. It says nothing about the start of our present age of wars, of globally expansionist tyrannies, and of the perversion of democratic government into an instrument whereby each interest group seeks to plunder society in general, to the unintended net loss of practically all.

If I were asked for my recommendation, therefore, I would not merely recommend going back to the gold standard. By itself, apart from restoration of its preconditions, that would hardly be a constructive step. My nostalgia is for the whole pre-1914 climate, not for one specific facet of it. I recommend repealing World War I, root and branch. If only we could!

15.7 Attitudes Necessary for Sound Money

Repealing World War I would have to include restoring certain attitudes that seem to have been more prevalent in public affairs before 1914 than they are now. Those attitudes favored limitations on the scope of government activity and restraint on seeking special advantage through

the instrumentality of government. Broadly speaking, these were liberal attitudes in the nineteenth-century sense. These attitudes have now been undermined in ways analyzed, in part, by Ortega y Gasset in *The Revolt of the Masses*.

Nowadays, we have tyranny in the nondemocratic countries and, in the democratic countries, democracy perverted in such a way that political decisions are made out of short-run expediency and without due regard for long-run consequences. But in the gold-standard era, as Lars Jonung says, "the democratic system had not been fully developed." (Peter Lindert detects signs of the perversion of democracy in the United Kingdom, however, even before World War I.)

Without a return to liberal attitudes and self-restraints, 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-enforcing than any other set of monetary rules. Michele Fratianni has been telling us of the readiness of Italian politicians to throw out the gold standard, and Peter Lindert has noted the propensity of the gold standard and key-currency systems to collapse when shocked. (Even today, before we have gone back to a supposed gold standard, there is plenty of reason for suspecting that what some of its supporters are advocating is not a real but a pseudo gold standard, to echo a distinction made by Milton Friedman [1961, pp. 66–79].)

Maybe some hope is to be found in constitutional restraints on government taxing and spending, maybe in the depoliticization of money. It would be outside my assignment to discuss these possibilities tonight. My purpose, rather, has been to set our examination of the classical gold standard into the context of the conditions and attitudes that apparently prevailed at the time.

Given the required attitudes and the related restraints on government, the gold standard is not the only set of monetary arrangements that would function tolerably well. Economists can easily imagine, and have proposed, monetary arrangements that would function better.

The required attitudes were illustrated in Austria even while the country was still on fiat paper money. The government and the financial press repeatedly agonized even over budget deficits that would seem delightfully small to us today. Although the price level was generally steady or even trending mildly downward (except during wars and immediately afterward), the government and the press worried about the value of money as reflected in the exchange rate. (Nowadays, attention would more suitably focus on a price index.) The *Neue Freie Presse* took exchange rates of 120 guldens or higher for ten pounds sterling as a particularly ominous warning.

I will conclude with three quotations from that newspaper.

> London: 120! A cannon shot cannot shock us more than this figure; and it also forms an urgent warning for the many finance ministers of the Monarchy to maintain moderation, to retrench, to resume the policy of soundness. . . . When the exchange rates, this manometer of credit, rise, then it is better to reef in the sails a bit. Is it really our fate eternally to bear the mark of shame of a disordered currency? Will there never come a chancellor of the treasury who will have the will and also the power to restore the most important basis of the economy? (14 October 1883)
>
> The price of foreign bills is the loudest and gravest accusation against the government. . . . [When the opposition parties] want to depict the sad condition of the state with one stroke, then they need only unfold the Cursblatt [sic] and say: Things have gone pretty far in Austria when one franc equals half of our gulden on the world market. . . . what the ghosts were for poor Macbeth, the foreign exchanges are for [Finance Minister] Dunajewski; indeed, we are convinced that he often wakes up at night, terrified, and suddenly perceives a figure before him that mockingly hisses at him: London 126.50! (26 April 1885)

To introduce my final quotation, I should explain that the Austrian police from time to time confiscated issues of publications containing articles considered too critical of the government. The *Neue Freie Presse* occasionally carried a notice on its front page saying that its preceding issue had been confiscated. (To compensate its subscribers, the newspaper would either reprint the confiscated issue without the offending material or else make the next issue especially large.) In one of its editorials denouncing the confiscations, the paper complained about discrimination, as well: Unlike itself, the official *Coursblatt* of the Vienna Bourse had *never* been confiscated. Yet its latest issue quoted London exchange at 120.95. "And if we were to write our fingers sore, we could not portray the situation more precisely. Confiscate the Cursblatt [sic], Mr. Attorney General" (26 February 1882).

Notes

1. Cf. Menger 1936, pp. 147, 196, 233–34.

2. The quotation is from the 14 July 1892 transcript. Menger had previously used the same argument on 25 May, p. 6192.

3. These include some of the expert witnesses testifying before commissions convoked in Vienna and Budapest in March 1892 and in St. Petersburg in March–April 1896. See Austria, Währungs-Enquête Commission 1892; Imperatorskoe Voljnoe .Ekonomicheskoe Obshchestvo 1896.

4. Cf. Menger 1936, pp. 138–39, 226–27.

5. Landesberger thus seemed to imply that *if* the supply of a fiat money *could* be regulated appropriately, exchange-rate fluctuations would not count decisively against that

system. Some people, he noted, even considered the fluctuations a desirable insulator against price deflation in gold countries.

6. These arguments are reported in Vlasenko 1963, pp. 85–86; Raffalovich 1896, p. 369; Trakhtenberg 1962, pp. 174ff; and Finance Minister Witte's bill to authorize contracts in gold currency, quoted in Saenger 1927, p. 16.

7. Vienna Board of Trade 1887, p. 388; Kamitz 1949, pp. 147–48; *Aktiönar*, 22 June 1890, first supplement, dispatch from Prague; Silin 1913, pp. 394, 395, 399, quoted and paraphrased at length in Trakhtenberg 1962, pp. 265–66. Tisza (1890, esp. pp. 93–95) explained the incorrectness of the earlier fears and argued that the gold standard would serve Hungarian interests.

8. Witte 1921, pp. 59–60; cf. Von Laue 1963; Crisp 1967, p. 211; Migulin 1899–1904, pp. 130–31.

9. Witte 1921, pp. 59, 61; Von Laue 1963, pp. 141–44; Migulin 1899–1904, pp. 284–86; Trakhtenberg 1962, p. 267; Russia, Finance Ministry 1902, 2: pp. 422–25.

10. Earlier (1 November 1884) the same newspaper had exclaimed, "What enthusiasm it would stir up if at last the warmly longed-for moment had arrived to raise Austria onto the height of the civilized states!"

11. This process was so clearly described by Knut Wicksell back in 1898 that I propose calling it the "Wicksell process" (to be distinguished from his "cumulative process," which is rather different). *See* Wicksell 1965, pp. 39–41.

12. The *Neue Freie Presse* (Vienna) and *Aktiońar* (Berlin), both evident organs of liberal bourgeois thought, repeatedly stressed that peace was good for business.

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