The Free Market

February 1986 • The Ludwig von Mises Institute

The World Currency Crisis

by Murray N. Rothbard

I: Keynesians and Fixed Exchange Rates, 1944-73

The world is in permanent monetary crisis, but once in a while, the crisis flares up acutely, and we noisily shift gears from one flawed monetary system to another. We go back and forth from fixed paper rates to fluctuating rates, to some inchoate and aborted blend of the two. Each new system, each basic change, is hailed extravagantly by economists, bankers, the financial press, politicians, and central banks, as the final and permanent solution to our persistent monetary woes.

Then, after some years, the inevitable breakdown occurs, and the Establishment trots out another bauble, another wondrous monetary nostrum for us to admire. Right now we are on the edge of another shift.

To stop this shell game, we must first understand it. First, we must realize that there are three coherent systems of international money, of which only one is sound and non-inflationary. The sound money is the genuine gold standard; "genuine" in the sense that each currency is defined as a certain unit of weight of gold, and is redeemable at that weight.

Exchange rates between currencies were "fixed" in the sense that each was defined as a given weight of gold; for example, since the dollar was defined as one-twentieth of a gold ounce and the pound sterling as .24 of a gold ounce, the exchange rate between the two was naturally fixed at their proportionate gold weights, i.e., £1 = $4.87.

The other two systems are the Keynesian ideal, where all currencies are fixed in terms of an international paper unit, and the Friedmanite-monetarist vision of a world of freely fluctuating independent fiat paper moneys. Keynes wanted to call his new world paper unit the *bancor* while U.S. Treasury official (and secret Communist) Harry Dexter White wanted to name it the *unita*. *Bancor* or *unita*, these new paper tickets would ideally be issued by a World Reserve Bank and would form the reserves of the various central banks. Then, the World Reserve Bank could inflate the *bancor* at will, and the *bancor* would provide reserves upon which the Fed, the Bank of England, etc. could pyramid a multiple expansion of their respective national fiat currencies.

The whole world would then be able to inflate together, and therefore not suffer the inconvenience of inflationary countries losing either gold or income to sound-money countries. All the countries could inflate in a centrally-coordinated fashion, and we could suffer manipulation and inflation by a world government-banking elite without check or hindrance. At the end of the road would be a horrendous world-wide hyper-inflation, with no way of escaping into sounder or less inflated currencies.

Fortunately, national rivalries have prevented the Keynesians from achieving their goal, and so they had to settle for "second best," the Bretton Woods system that the U.S. and Britain foisted on the world in 1944, and which lasted until its collapse in 1971. Instead of the *bancor*, the dollar served as the international reserve upon which other currencies could pyramid their money and credit. The

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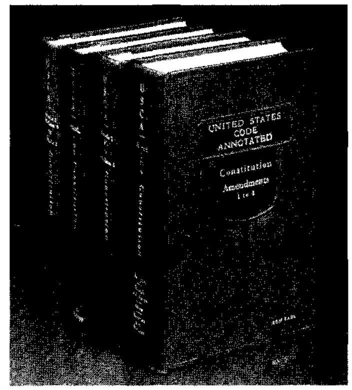


Former Congressman Ron Paul has donated his personal set of the U.S. Code to the Mises Institute's library. "These 250 books, used during his service in the U.S. House of Representatives, are a great resource," said Institute president Lew Rockwell. "But they have a special significance for us because of Congressman Paul's courageous fight for the gold standard, the free market, and Austrian economics in the tradition of Ludwig von Mises."

From the President

Washington's Royalist Architecture

by Llewellyn H. Rockwell, Jr.

Every single modern government building in Washington, D.C., seems intended as a monument to the glory and power of the State (or what the State would like us to think is its power and glory). Each is designed—through mountainous marble facades, cavernous rooms, mammoth and confusing corridors, and other old-as-the-pharaohs architectural devices—to demean the individual and exalt the government.

A leader in every area, Congress has some of the outstanding examples. Its Rayburn House Office Building, styled in a combination of Mussolini Modern and Texas Penitentiary, has 12 gigantic marble sculptures that have always symbolized government to me. Each one shows a large horn of plenty ending in a winged gargoyle. All the people's money pours into this reverse cornucopia and brings forth a monster.

Another piece of Stalinist architecture is the Library of Congress's new Annex. An Everest of marble that cost an Everest of dollars, its one good feature is a quote from James Madison: "What spectacle can be more edifying or more seasonable, than that of liberty & learning, each leaning on the other for their mutual & surest support?"

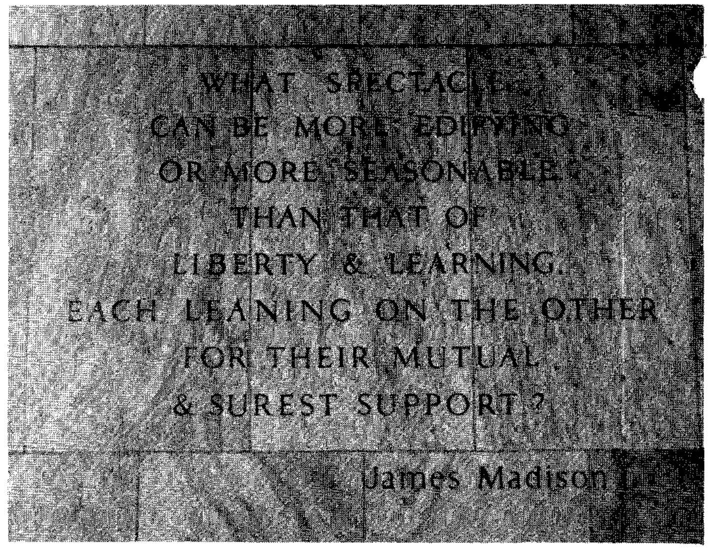
In the era of the Founding Fathers, even large public buildings tended to be built to human scale. They did not seek to obliterate the individual, but to uphold him.

After our country's founding, there was a debate on this very question of the size and munificence of public buildings. Should the U.S. ape London and Versailles, or should we make a new beginning here as well? As in so much else, the royalist (and pro-paper money) Hamiltonians eventually won out over the republican (and pro-gold standard) Jeffersonians.

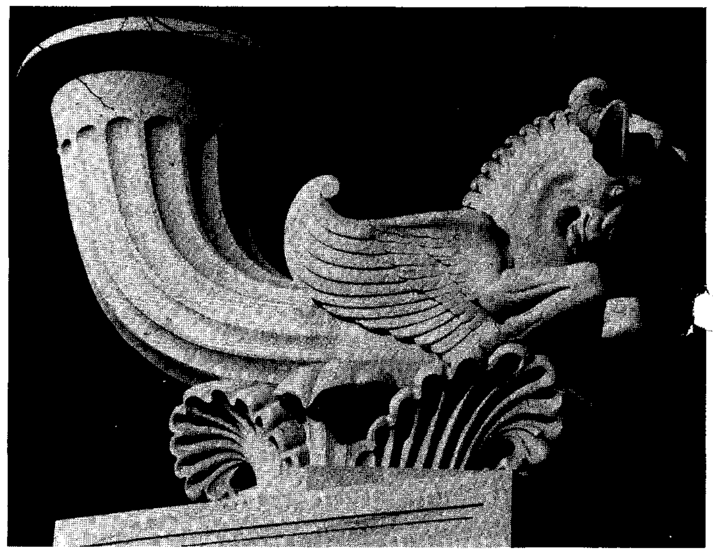
Thus even in architecture we can trace the growing and malevolent power of the State, and the consequent diminution of the individual and of society, which is the non-governmental sphere of human action.

It is indeed learning—in free-market economics and elsewhere—that provides liberty with its surest support. Ludwig von Mises devoted his life to this idea, and the Mises Institute is dedicated to it as well.

Political action for freedom is necessary, but it can only succeed after the educational foundation has been laid. Without this base, politics results only in victory for our enemies. ■



Inscription on the Library of Congress



The government as it sees itself?

Lew Rockwell, founder of the Mises Institute, has received the George Washington Honor Medal from Freedoms Foundation at Valley Forge for his "outstanding work in economic education."

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dollar, in turn, was tied to gold in a mockery of a genuine gold standard, at the pre-war par of $35 per ounce. In the first place, dollars were not redeemable in gold coins, as they had been before, but only in large and heavy gold bars, which were worth many thousands of dollars. And secondly, only foreign governments and central banks could redeem their dollars in gold even on this limited basis.

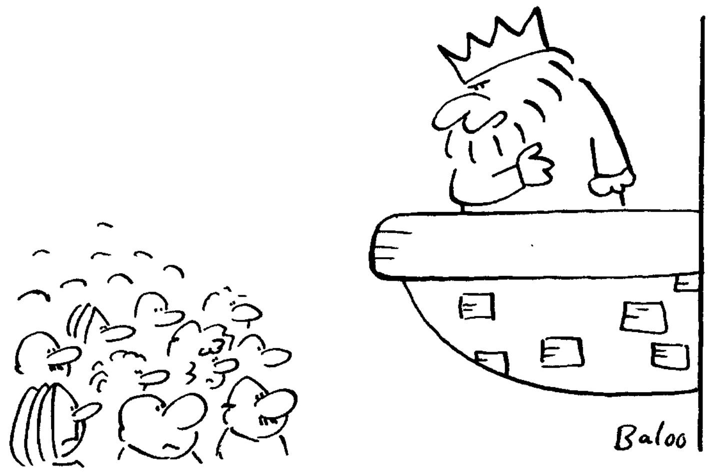
For two decades, the system seemed to work well, as the U.S. issued more and more dollars, and they were then used by foreign central banks as a base for their own inflation. In short, for years the U.S. was able to "export inflation" to foreign countries without suffering the ravages itself. Eventually, however, the ever-more inflated dollar became depreciated on the gold market, and the lure of high priced gold they could obtain from the U.S. at the bargain $35 per ounce led European central banks to cash in dollars for gold. The house of cards collapsed when President Nixon, in an ignominious declaration of bankruptcy, slammed shut the gold window and went off the last remnants of the gold standard in August 1971.

With Bretton Woods gone, the Western powers now tried a system that was not only unstable but also incoherent: fixing exchange rates without gold or even any international paper money with which to make payments. The Western powers signed the ill-fated Smithsonian Agreement on December 18, 1971, which was hailed by President Nixon as "the greatest monetary agreement in the history of the world." But if currencies are purely fiat, with no international money, they become goods in themselves, and fixed exchange rates are then bound to violate the market rates set by supply and demand.

At that time the inflated dollar was heavily overvalued in regard to Western European and Japanese currencies. At the overvalued dollar rate, there were repeated scrambles to buy European and Japanese moneys at bargain rates, and to get rid of dollars. Repeated "shortages" of the harder moneys resulted from this maximum price control of their exchange rates. Finally, panic selling of the dollar broke the Smithsonian system apart in March 1973. With the collapse of Bretton Woods and the far more rapid disintegration of the "greatest monetary agreement" in world history, both the phony gold standard and the fixed paper exchange rate systems were widely and correctly seen to be inherent failures. The world now embarked, almost by accident, on a new era: a world of fluctuating fiat paper moneys. Friedmanite monetarism was to have its day in the sun.

II: Monetarists and Fluctuating Fiat Monies, 1973-?

The Friedmanite monetarists had now come into their



"What's the matter with you people? Taxes don't destroy my incentive!"

own, replacing the Keynesians as the favorites of the financial press and of the international monetary establishment. Governments and central banks began to hail the soundness and permanence of fluctuating exchange rates as fervently as they had once trumpeted the eternal virtues of Bretton Woods. The monetarists proclaimed the ideal international monetary system to be freely fluctuating exchange rates between different moneys, with no government intervention to try to stabilize or even moderate the fluctuations. In that way, exchange rates would reflect, from day to day, the fluctuations of supply and demand, just as prices do on the free market.

Of course, the world *had* suffered mightily from fluctuating fiat money in the not too distant past: the 1930s, when every country had gone off gold (a phony gold standard preserved for foreign central banks by the United States). The problem is that each nation-State kept fixing its exchange rates, and the result was currency blocs, aggressive devaluations attempting to expand exports and restrict imports, and economic warfare culminating in World War II. So the monetarists were insistent that the fluctuations must be absolutely free of all government intervention.

But, in the first place, the Friedmanite plan is *politically* so naive as to be almost impossible to put into practice. For what the monetarists do, in effect, is to make each currency fiat paper issued by the national government. They give total power over money to that government and its central bank, and then they issue stern admonitions to the wielders of absolute power: "Remember, use your power wisely, *don't* under any circumstances interfere with exchange rates." But inevitably, governments will find many reasons to interfere: to force exchange rates up or down, or stabilize them, and there is nothing to stop them from exercising their natural instincts to control and intervene.

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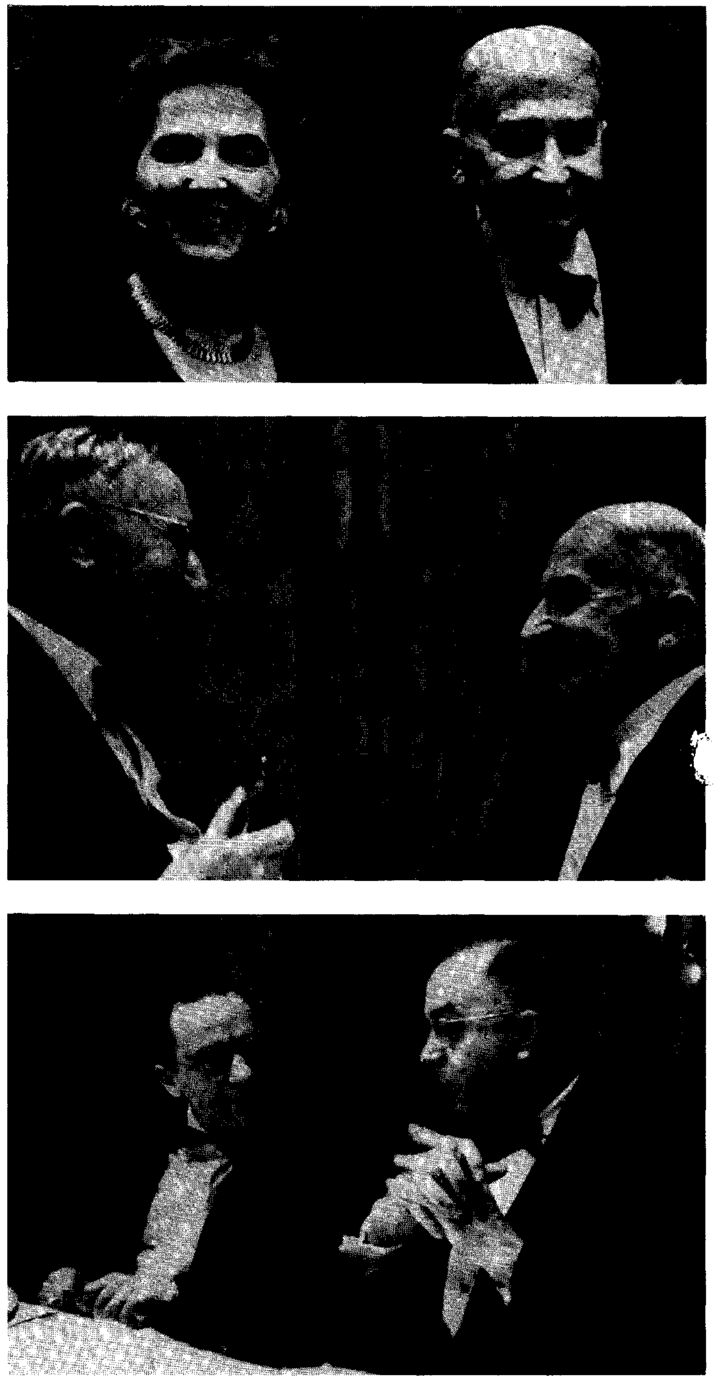
And so what we have had since 1973 is an incoherent blend of "fixed" and fluctuating, unhampered and hampered, foreign currency markets. Even Beryl W. Sprinkel, a dedicated monetarist who served as Undersecretary of Treasury for Monetary Policy in the first Reagan Administration, was forced to backtrack on his early achievement of persuading the Administration to decontrol exchange rates. Even he was compelled to intervene in "emergency" situations, and now the second Reagan Administration is moving insistently in the direction of refixing exchange rates.

The problem with freely fluctuating rates is not only political. One virtue of fixed rates, especially under gold but even to some extent under paper, is that they keep a check on national inflation by central banks. The virtue of fluctuating rates—that they prevent sudden monetary crises due to arbitrarily valued currencies—is a mixed blessing, because at least those crises provided a much-needed restraint on domestic inflation. Freely fluctuating rates mean that the only damper on domestic inflation is that the currency might depreciate. Yet countries often *want* their money to depreciate, as we have seen in the recent agitation to soften the dollar and thereby subsidize exports and restrict imports—a back-door protectionism. The current refixers have one sound point: that worldwide inflation only became rampant in the mid and late 1970s, after the last fixed-rate discipline was removed.

The refixers are on the march. During November 1985, a major, well-publicized international monetary conference took place in Washington, organized by Representative Jack Kemp and Senator Bill Bradley, and including representatives from the Fed, foreign central banks, and Wall Street banks. This liberal-conservative spectrum agreed on the basic objective: refixing exchange rates. But refixing is no solution; it will only bring back the arbitrary valuations, and the breakdowns of Bretton Woods and the Smithsonian. Probably what we will get eventually is a world-wide application of the current "snake," in which Western European currencies are tied together so that they can fluctuate but only within a fixed zone. This pointless and inchoate blend of fixed and fluctuating currencies can only bring us the problems of both systems.

When will we realize that only a genuine gold standard can bring us the *virtues* of both systems and a great deal more: free markets, absence of inflation, and exchange rates that are fixed not arbitrarily by government but as units of weights of a precious market commodity, gold? ■

Dr. Rothbard is the Ludwig von Mises Institute's vice president for academic affairs.



Professor and Mrs. Murray N. Rothbard recently donated a collection of historic photographs to the Institute. Taken at a dinner in honor of Ludwig von Mises in 1955, three of them show (top) Margit and Ludwig von Mises; (center) Mises-student F.A. Hayek and Professor Mises; and (bottom) Mises-student Murray Rothbard and F.A. Harper, founder of the Institute for Humane Studies.