

# Austrian Economics Newsletter

## The Other Side of the Coin: Free Banking in Chile

by Murray N. Rothbard

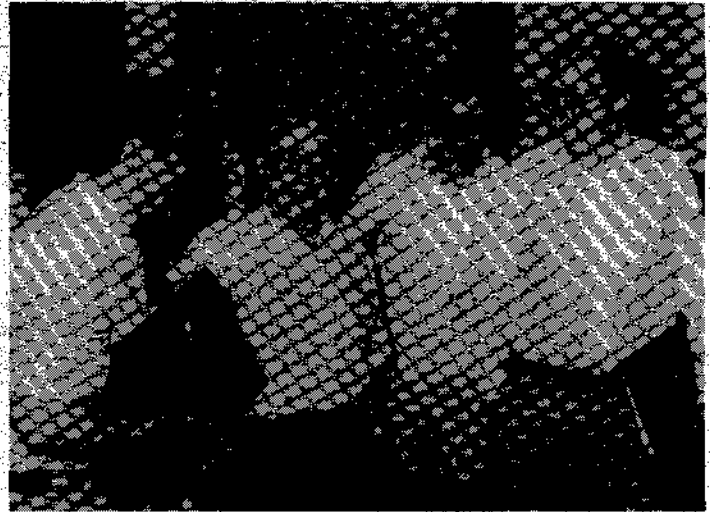
In recent years, disillusionment in central banking has understandably set in among many economists. As a result, some writers have turned to the alternative of free banking, praising both the theoretical model and historical cases in which free banking has allegedly worked effectively. But there may have been an unwise rush to judgment.<sup>1</sup> It is high time that we call attention to the other side of the coin: the apparent disaster of free banking in nineteenth-century Chile.

During the first half of the nineteenth century, Chile was a haven of monetary and financial stability, the envy of Latin America. The reason was not simply that the country had no central bank; more importantly, Chile had no paper money or fractional reserve banking at all! For the Chilean leadership was devoted to the idea of pure, 100 percent commodity money. Thus, in 1824, the Chilean Finance Minister strongly opposed the introduction of even convertible, fractional reserve bank notes. Such notes would be admitted, he warned, "only at the point of the bayonet. The person who dared to propose it would be looked upon as a dreamer, a tyrant, even a heretic."<sup>2</sup>

Throughout the 1830s and 1840s, Chile rejected proposals for a governmental paper bank, due to fears of mismanagement and inflation. In 1839, the government passed a law banning any bank paper issue without government permission, and required that any permitted issue had to be fully guaranteed by the bank. The result was the virtual absence of paper money in Chile. In 1848, the Minister of Finance, Manuel Camilo Vial, ruefully stated that he would have liked to establish a governmental bank, but found it politically impossible to do so: "I would not have hesitated to propose the establishment of a bank by the government were I not aware of the almost insuperable opposition which many of the most distinguished citizens of the country have to such an idea..."<sup>3</sup> Three years later, the then-Minister of Finance prayed: "May we hold ourselves aloof from institutions such as banks of issue!"

Only one breach of this principle occurred before the end of the 1850s. In 1849, the government granted the right of note issue to the Banco de Chile: but large-scale protests by merchants and an adverse Supreme Court decision caused the bank to close its doors the following year.<sup>4</sup>

Into this idyll of hard money and monetary stability, there stepped, unfortunately, one man with an idea. As an



*Students and faculty alike find the informal discussion time a valuable aspect of the Mises Institute's summer conferences. Dr. Gordon, Professors Rothbard and Hoppe and a student continue a discussion during a break at last summer's Introductory Course in Austrian Economics at Dartmouth.*

undeveloped country, Chile was understandably in awe of European knowledge and civilization, and in 1853 it hired as its first professor of economics in the new University of Santiago the French economist and banking theorist Jean Gustave Courcelle-Seneuil (1813-1892), who was also to serve as an official economic adviser to the Chilean Ministry of Finance.<sup>5</sup> Courcelle-Seneuil was devoted to free trade and laissez-faire in general, but his major interest was in the abolition of central banking and the establishment of a free banking system. Entering an academic vacuum, Professor Courcelle-Seneuil quickly became extremely influential in Chile, persuading the government to enact a free banking law drafted by himself in 1860. His

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charismatic teaching style produced a host of highly influential disciples, who dominated Chilean economic thought and political economy for decades.

The Law of 1860 created a free bankers' paradise in Chile. Anyone or any group could set up a bank and issue notes. There were no reserve requirements, no minimum capital or loan requirements, no limits on loans to directors, and no inspection by government agencies. Only two minor restrictions were imposed: a maximum note issue of 150% of the bank's capital, and a ban on very small denomination notes under 20 pesos. All else was permitted, within, of course, the standard free-banking framework of requiring banks to redeem their notes in gold on demand.<sup>6</sup> The Law of 1860 continued to be the basic banking law of Chile until 1925.

As a result of the new system of free banking, however, Chile rapidly embarked on a long-run, generally accelerating course of inflation. The old haven of hard money and financial stability was no more.

It took less than five years for the brave new free banking system to collapse. In 1864, Spain and Peru went to war over the Guano Islands off the coast of South America, and Chile went to the aid of Peru, declaring war on Spain on September 24, 1865. By the outbreak of war, the free banks had inflated to such an extent that they were vulnerable to insolvency in a major crisis. Hence, the war scare of 1865 led to massive withdrawals of bank deposits and the cashing of notes from the fractional reserve banks. At the point of insolvency, the banks were promptly saved by the Chilean government, which now embarked on a path of inconvertible bank paper. First, five days after the declaration of war, it authorized the new Banco Nacional de Chile to issue a mass of inconvertible bank notes, stipulating (a) that the inconvertibility

*Edwin W. Kemmerer, the American "money doctor" on one of his trips to South America to help with monetary "reforms" that led to the creation of the Chilean central bank.*



would last only for 90 days and (b) that the maximum note issue would be 1.5 million pesos. The fiat notes would not be legal tender, but would be receivable in taxes or other payments to the government. Second, the government induced four of the leading banks to agree to receive the Banco Nacional notes at par, and also to turn over to the government all coin taken in to help eventually redeem the bank notes received by the government. Third, the government agreed to issue 1 million pesos worth of bonds to be kept as a guarantee for any of the inconvertible bank notes received by the government.

As always happens with monetary expansion, this first step was but the tentative beginning of the inflation program. Another law was passed at the end of December, delaying specie convertibility until six months after the war with Spain was over, or, at the latest, by the end of June 1867. In addition, more inconvertible bank notes were made receivable in taxes.

Fiscal needs escalated rapidly as the blockade by the Spanish navy led to a fall in customs revenue, and to difficulty in repaying the public debt, held mainly by England. The next step in the acceleration of inflation came in July 1866. The government borrowed massively from banks to help pay the foreign debt; in return, the government bestowed a host of special privileges on the banks. The law of the previous December was repealed. From now on, there were to be no restrictions on the amount of loans or note issue by the banks; all bank notes would be inconvertible until six months after the war, or June 1867 at the latest. All banks lending money to the government would agree to receive each others' notes at par for twenty-two years, to the extent of 4.5 million pesos. For this massive set of privileges, the banks agreed to pay the government a fee of 2 percent per annum on any inconvertible notes outstanding.

Fortunately, the war was shortly over, and convertibility into specie was soon resumed. But the signal had been given to the banks that the government would bail them out in times of real financial trouble, and so an inflationary boom soon began, fueled by bank credit expansion and ensuing speculation. The bank credit boom after 1866 led to a speculative boom in mining, as well as an increase in wheat and copper prices. Frank Fetter notes that "the banks were doing business on a very small margin of safety."<sup>7</sup>

Booms always give way to busts, and a depression set in by 1874. Farmers and landlords went even more heavily into debt, and total agricultural debt in arrears rose to 11.7% in 1877 and to a staggering 33.6% in 1879. There was a heavy depression in the mining industries. The Chilean government incurred heavy deficits from 1874 on. Having exhausted private nonbank credit sources after several years, the government in June of 1878 finally turned to the already overextended banks, borrowing 2.5 million pesos per year for two years. In turn, the Treasury allowed the lending banks to issue 10.1 million pesos in bank notes, to be receivable in taxes.

This inflationary issue of bank notes led to domestic inflation and to a rapid export of specie. The "free" banks were now on the ropes, then quickly, on July 23, 1878, the

Chilean government authorized all of the banks participating in the recent loan to immediately suspend specie payments "temporarily"—until the end of August 1879. In the meanwhile, these now fiat bank notes would serve as legal tender. In fact, this "temporary" inconvertibility was to last for nearly fifty years. Chile had been plunged into the inflationary world of fiat money, and had done so in the absence of a central bank, in fact in the midst of a supposedly ideal system of free banking.

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**Central banking and free banking are not the only two possible monetary alternatives. A third route is freedom of banking within a firm matrix of 100 percent specie reserves.**

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The fateful suspension of specie payment in 1878 was blamed, as usual in such situations, on the "unfavorable balance of payments," no recognition being given to the cause of that balance—the domestic bank credit inflation. The actual reason for the suspension was the imminent bankruptcy of several of the largest banks participating in the government loan. Just before the suspension, on June 30, 1878, demand liabilities of the Chilean commercial banks totalled 46.8 million pesos; specie reserves of the banks totalled only 3.45 million pesos, a reserve ratio of 7.4%. Even during prosperity at the end of 1869, total reserves had constituted only 8% of demand liabilities. The largest lending bank, and the most ardent advocate of suspension, the Banco Nacional, was the most unsound of the banks. Not only was its reserve ratio in 1869 far lower than the average of 5%, it also engaged in large-scale loans to its own directors. Just before suspension, on July 11, it had loaned out no less than one-half of its capital to its own directors.

During the next half-century, Chile made only one feeble attempt to return to gold. In 1895, when the market exchange rate between the peso and English pound was 14 pence to the peso, the Chilean government insisted on returning to gold at 18 pence to the peso. The subsequent appreciation of the peso and monetary and price deflation in Chile led to a run on the banks in 1898, and a permanent return to fiat money.

The fiat system and the legacy of Professor Courcelle-Seneuil finally came to an end in 1925, when the American "money doctor," Edwin W. Kemmerer, in a mission to Chile, succeeded in imposing yet another of his monetary "reforms." The 1925 reform repealed the Law of 1860, imposed a Central Bank, and engineered a return to a gold exchange standard, in which the peso was only nominally tied to gold, and was actually tied to the dollar. A few years later, the Chilean experiment joined the other gold-exchange standard nations in the dustbin of history, and fiat paper money was established permanently.<sup>8</sup>

And what of Courcelle-Seneuil? He had the good fortune to return in triumph to France in 1863, after the victory of his ideas and before their consequences would

become apparent. While in Chile, his *magnum opus*, a two-volume treatise on political economy, was published in France in 1858, and the grateful Chilean government financed a Spanish translation. After his return to France, he continued as a prolific writer on banking, economic and historical topics, and himself translated works on political economy from the English into French. He was appointed a member of the Council of State in 1879 and elected a member of the prestigious Academy of Moral and Political Sciences three years later.

Unfortunately, Courcelle-Seneuil's reputation did not fare nearly so well in the country of his major influence. Courcelle-Seneuil is still, to this day, de-nounced bitterly by Chileans as being personally responsible for the continuing history of inflation as well as for nearly all other economic ills. As Albert Hirschman notes, Courcelle-Seneuil has been "demonized."<sup>9</sup> Unfortunately, his free-banking inflation also in retrospect discredited other, far superior reforms due to his influence: e.g., a drastic cut in Chilean tariffs in 1860, as well as the privatization of nitrate mines conquered in a war against Peru in the early 1880s. Thus, Professor Courcelle-Seneuil's legacy in banking was successfully used to discredit his other, more beneficial contributions to the Chilean economy.

The Chilean experience highlights an important point: that central banking and free-banking are not the only possible monetary alternatives. A third route is freedom of banking within a firm matrix of 100 percent specie reserves, any fractional reserve issue being considered a violation of the general laws against fraud and theft.

#### Notes

I am greatly indebted to Professor Joseph Salerno of Pace University for calling my attention to this problem and to the relevant literature.

<sup>1</sup>On the most prominent example of this undue haste, see Murray N. Rothbard, "The Myth of Free Banking in Scotland," *Review of Austrian Economics*, 2 (1988), pp. 229-245; and Larry J. Sechrest, "White's Free-Banking Thesis: A Case of Mistaken Identity," *Review of Austrian Economics*, 2 (1988), pp. 247-257.

<sup>2</sup>Albert O. Hirschman, *Journeys Toward Progress* (New York: Doubleday, 1965), pp. 221.

<sup>3</sup>Frank W. Fetter, *Monetary Inflation in Chile* (Princeton: Princeton University Press, 1931), p. 7.

<sup>4</sup>During the 1850s, two commercial houses in Santiago began to issue and circulate notes, but at least one of them, the Banco de Valparaiso was prohibited from issuing notes by a special law in 1855. *Ibid.*

<sup>5</sup>Born in the Dordogne, Courcelle-Seneuil had studied law, managed an industrial firm in his home province, had written many articles for the *Journal des Economistes*, and had published a small book in 1840 on *Credit and Banking*. He briefly held a high post in the French Ministry of Finance after the 1848 revolution, and published a successful textbook on banking in 1852. Albert O. Hirschman, "Jean Gustave Courcelle-Seneuil (1813-1892)," *The New Palgrave: Dictionary of Economics*, I (London: Macmillan, 1987), pp. 706-708.

<sup>6</sup>Before independence from Spain, the Chilean currency consisted solely of freely circulated European gold and silver coins. Independent Chile imposed a bimetallic

standard, but the fixed rate of 16.5:1 overvalued gold and undervalued silver, and the result was an effective gold standard. In 1851, the fixed ratio was changed to 16.4:1, but silver was still undervalued, and the gold standard continued.

<sup>7</sup>Fetter, *Monetary Inflation*, p. 25.

<sup>8</sup>On the farflung activities of Edwin O. Kemmerer in imposing the gold-exchange standard and central banking in the Third World, see Robert N. Seidel, "American Reformers Abroad: the Kemmerer Missions in South America, 1923-31," *Journal of Economic History*, 32 (June 1972), pp. 520-545; Emily S. Rosenberg and Norman L. Rosenberg, "From Colonialism to Professionalism: the Public-Private Dynamic in United States Foreign Financial Advising, 1898-1929," *Journal of American History*, 74 (June 1987); and Murray N. Rothbard, "The Origins of the Federal Reserve," (unpublished MS), pp. 50, 60-61.

<sup>9</sup>Hirschman, "Courcelle-Seneuil," p. 707.

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## The Implications of Freedom in Banking and Note Issue

by George A. Selgin

(This article is the first of two parts based on a lecture given at the Mises Institute's Austrian Economics Colloquium at Auburn University.)

I wish to defend two controversial claims in this article. The first is that the monopolization of banknote issue by monetary authorities all over the world has been the greatest blunder ever committed in monetary and banking policy. The second is that economists' failure to clearly understand the implications of monopolized note issue has been the greatest blunder ever committed in monetary and banking theory. Monopolized note issue is a policy blunder because it has been the main cause of instability of money supply and of consequent monetary disturbances. Had note issue been allowed to develop freely and competitively, we probably would not have come to think of money as something that "will not manage itself." The failure of theorists to understand the implications of monopolized note issue has been a blunder of theory because it has led to their approval of monopoly in the one industry where it could do the greatest harm.

### Note Issue and Monetary Stability

What is meant by monetary stability? How do we want the banking system to behave? I take for granted that monetary stability means that the supply of money is neither excessive nor deficient relative to the wants of the public. To accomplish this, a banking system should increase the supply of bank money whenever the public's demand for it—relative to some given level of income—grows, and it should reduce the supply of money whenever the public's demand for it relative to its income falls. At all other times the supply of money should not be changed at all. Finally, the banking system should supply the public with the right mixture of different types of bank money, including currency and deposits of different kinds.

Obviously, real-world banking systems do not work this way. Why is that? The three most important reasons are as follows: 1) unwarranted changes in the supply of "base" or "high-powered" money—the stuff banks hold in reserve; 2) unwarranted changes in the reserve ratio; and, 3) unaccommodated changes in the public's relative demand for currency. The first of these reasons is the main cause of undesirable, secular maladjustment of the money supply, whereas the third is the most important cause of cyclical maladjustment. This, at least, has been true for all banking systems with a centralized currency-issue. But how significant would these causes of disequilibrium be in a system with competitive note issue? The answer is, not very. Compared to centralized banking, free banking offers relatively little scope for disequilibrium money supply.

Consider first the matter of the monetary base. In monetary systems with centralized note issue, the liabilities—both currency and deposits—of the privileged bank of issue inevitably become part of the supply of base



*George Selgin presented his paper on "The Implications of Freedom in Banking and Note Issue" to students and faculty at the Austrian Economics Colloquium sponsored by the Mises Institute at Auburn University.*

money. That is true even with a commodity standard; with a fiat standard the liabilities of the central bank are the only kind of base money. This comes about because other banks, stripped of their right to issue notes, are anxious to keep on hand notes issued by the central bank to give to their customers who ask for cash.

Even under a gold standard, a contest for notes of the central bank develops among the unprivileged banks, taking the place of what (under free note issue) would be a contest for gold. Banks end up treating the central banks' liabilities as reserves, using them to settle clearings. Thus these liabilities become part of the monetary base—a kind of high-powered money. What's more, they are a most unstable type of high-powered money, because they can be increased or withdrawn at any time at the whim of the central bank. This causes a multiple expansion or contraction of loans and deposits by all other banks. All large inflations in recent history were a result of expansion of this kind of high-powered money; the economics of gold mining make it impossible for the supply of gold ever to expand for very long at an excessive rate.

Had note issue never been monopolized, the monetary base in most countries in the West would have consisted of gold: no bank would have exclusively been able to have its liabilities held by other banks as reserves, or used to settle their clearings with one another, instead of being routinely redeemed. Additions to the stock of monetary gold are, of course, limited by the profitability of gold mining. Notwithstanding conventional wisdom to the contrary, this makes the supply of monetary gold endogenous. Most of the alleged gold "supply shocks" in history actually occurred in response to falling prices, that is, they were provoked by an increase in the relative price of gold. They therefore represented movements along a gold-supply schedule rather than shifts in that schedule. Furthermore, many of these movements were a result of government interference in the monetary system, which

created deflationary pressures that would not have arisen under free banking. All told, then, changes in the monetary base would be a much less significant source of monetary disequilibrium under free banking than they have been under central banking.

All of this assumes free banking has to be based on a commodity, such as gold. Today, another alternative exists: to establish free banking on the basis of a frozen stock of fiat base money, such as Federal Reserve Notes. In this arrangement banks would issue paper claims redeemable in base dollars, to be held by the public; the base dollars themselves, however, could be used exclusively as bank reserves. Obviously this kind of reform would provide no scope at all for monetary disequilibrium stemming from unwanted changes in the size of the monetary base.

Next let's consider how the reserve ratio would behave in a free banking system. It is often assumed that unregulated banks, issuing convertible notes, could expand their issues without limit because they would not be under pressure to hold any definite fraction of base money reserves. Statements in many textbooks even imply that this would occur with checkable deposits were it not for the presence of statutory reserve requirements. Yet in many countries for many years banks were not constrained by statutory reserve requirements, and the supply of deposits did not explode. This was even true when banks were relatively unhindered in their ability to issue notes.

What was it that made the reserve multiplier finite in these banking systems? For competitively issued notes, just as for deposits, any issue in excess of the public's aggregate needs (for some given level of income) leads to a redeposit of the excess, mainly at rival banks. Banks send the notes through the clearinghouse to be redeemed, like so many checks. Net clearing debits have to be settled in base money. Since the exact incidence of net debits cannot be known with certainty, every bank will, in anticipation of such debits arising at any particular clearing session, keep a balance of base money on hand. The size of the balance is determined according to the same principles which determine the size of other private firms' holdings of precautionary and transactions balances of bank deposits.

These determinants of reserve-demand do not imply a constant average reserve ratio; for in a free banking system there is one circumstance when the reserve ratio will change: it is when the public's real demand for free-bank notes and deposit credits expands or contracts over time. For example, as the demand for notes increases, more notes become "lodged" in circulation, and fewer enter the clearing mechanism. As a result of this, gross bank clearings fall along with other measures of nominal spending. Since the transactions and precautionary demand for bank reserves is positively related to the volume of clearings, the new, optimal reserve ratio will be lower than the actual ratio of bank reserves to liabilities. Assuming that the nominal supply of reserves is fixed, banks will adapt to the new situation by expanding their balance sheets through new loans and note issues until the volume of gross clearings returns to its former level. In effect, the banks offset changes in the velocity of money

with equal and opposite changes in its nominal quantity: the money multiplier adjusts passively to the wants of the public. This is very desirable; it is manifestly *not* what happens in regulated and centralized banking systems.

This brings us to the third and final cause of monetary disequilibrium in conventional banking systems: unaccommodated changes in the public's currency ratio, that is, in the public's preferred mixture of currency and deposit balances. It is now well known that, in centralized banking systems with a constant monetary base, an increase in the public's relative demand for currency leads to a net loss of bank reserves, which in turn leads to a much larger, disequilibrating fall in the volume of deposits. Likewise a fall in the demand for currency leads to an equal expansion of bank reserves, which—in the absence of adjustments by the central bank—will cause a disequilibrating, multiple expansion of deposits. Histori-

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**Had note issue never been monopolized, the monetary base in most countries in the West would have consisted of gold.**

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cally, such uncompensated changes in the demand for currency have been a very important cause of monetary crises. Here in the United States, an uncompensated fall in currency demand was largely responsible for the post-World War I inflationary boom. On the other hand, unaccommodated growth in currency demands played a major role in the pre-Federal Reserve money panics and also in the "Great Contraction" of 1930 to 1933.

Such disturbances caused by changes in currency demand are what monetarists like Henry Simons, Lloyd Mints, and Milton Friedman have in mind when they refer to the "inherent instability" of fractional reserve banking. Yet this instability is really not inherent in fractional reserve banking at all. It is only inherent in fractional-reserve banking systems that lack freedom of note issue, including, in particular, all central banking systems. This is because the notes of a privileged bank of issue come to lead a kind of "double life" as so-called "high-powered" money. These notes are not really always high powered: when in the hands of the public they resemble other types of "mild mannered" bank money. It is when they enter the tills of commercial banks that they become "super" money. The ebb and flow of these notes to and from bank reserves causes their power to change, thereby also causing the total money stock to increase and to diminish.

Nothing of the sort occurs under complete freedom of note issue. For here whenever a bank's customers come to it demanding currency in exchange for their deposits, the bank can simply draw upon a stock of notes produced, as it were, by its own printing press. On its balance sheet the bank debits the entry for "liabilities-deposits" and then credits the entry for "liabilities-circulation" by the exact same amount. The bank's liquidity—its reserve position—remains unaffected: the notes it has handed out over its counter were not part of its reserves, and they will not

become part of its reserves in the future when they are sent back for redemption. In short, a free banking system is readily capable of accommodating changes in the public's currency ratio simply by adjusting the form of its outstanding liabilities, without provoking any undesirable changes in the total quantity of those liabilities. Such a banking system is not "inherently unstable" in the sense meant by Friedman and Mints. Indeed, Friedman and Mints themselves realize this advantage of free note issue. That fact did not inspire them, however, to argue in favor of free banking. Friedman uncharacteristically dismissed the idea as being politically impossible, although he has recently become more open to it. As for Mints, he was frankly opposed to fractional reserve banking in any form; he did say, however, that those who weren't entirely opposed to fractional reserve banking were being inconsistent and illogical in not arguing for competitive note issue.

### Note Issue and Monetary Theory

Regrettably most economists failed to see any of the potential advantages for monetary stability of freedom in note issue. Instead, they completely misunderstood the role played by bank notes, treating them as if they must always be high-powered money, and using this approach to justify and defend the monopolization of note issue in banking systems everywhere. The irony is that it was really the monopoly privilege in note issue itself which caused notes to become high powered. The very thing that was perceived as giving central banks the power to control the money supply was also the principal cause of the money supply being out of control in the first place.

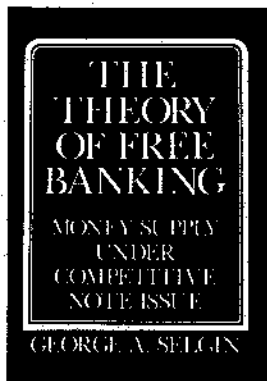
Take, for example, the case of England. The Bank of England enjoyed limited monopoly privileges in note issue from the time of its establishment in 1694. For the next century and a half, England was subjected to numerous monetary crises, including the long-lasting Bank Restriction during which the price of gold appreciated in terms of bank money. Many of these crises were blamed on the overissue of bank notes. But rather than appreciate the unique ability possessed by the Bank of England to engage all other banks in a general expansion, the reformers targeted the already underprivileged *country* banks for the strictest regulation. The ultimate consequence of Peel's Bank Act of 1844 was to strip those banks entirely of their powers of note issue, actually enhancing the power of the Bank of England. It was as if the traffic police revoked the licenses of a pack of speeding bicyclists without noticing that the bicycles were being chased by an out-of-control tank, and then put the tank in charge of directing traffic!

In the United States the most serious defects of the National Banking system can be traced to bond-deposit requirements on note issue and to restrictions against branch banking. But instead of acknowledging this and moving to a deregulated system, the authorities chose to heap another batch of bad regulations on top of the ones that had failed. The new system, because it was more centralized, was actually capable of even greater mischief than what it had replaced; yet when this fact was revealed

after no less than two decades its only effect was to launch still another batch of misguided banking regulations.

In short, economists' failure to understand the implications of freedom of note issue has led them to endorse monopoly in the one place where its effects could be most devastating. In so doing they helped to tarnish the invisible hand by involving it in regular monetary crises that were not a product of its own wrongdoing.

George Selgin is a lecturer at the University of Hong Kong. He will also be a member of the faculty for the Mises Institute's summer conference at Stanford University, July 8-15, 1989. ■



*George Selgin's book, Theory of Free Banking: Money Supply under Competitive Note Issue is available from the Ludwig von Mises Institute; \$25.00 hardback.*

## European Economic Integration and the ECU

by Hans-Hermann Hoppe

According to official, intergovernmental agreements, by 1992 a European central bank—most likely as an offshoot of the present European Monetary Cooperation Fund—will be established, and the ECU, in existence since 1979, will become the all-European currency supplanting the various European national monies. At the same time the economic integration of the ten current member states of the European Community will supposedly be complete.

There are some who, for one reason or another, doubt that this will actually happen, or that it will occur as soon as 1992. However, almost everyone thinks of it as 'a generally good idea'. Yet European integration and the ECU are nothing but bad news, economically as well as morally.

Public opinion, which will ultimately determine whether or not these plans will become reality, and which presently gives them so much favorable treatment, suffers from two fundamental misconceptions, spread and reinforced through deliberately deceptive government propaganda.

Public opinion is correct as regards its intuition that integration into wider markets is economically better than integration into a smaller one, and that a more

widely used money better functions as a medium of exchange than a less widely used one. It is misled, however, in supposing that European integration and the ECU—only because Europe is obviously larger than its national components and the ECU thus would circulate more widely than any national currency—have anything to do with wider markets or better money. The truth is precisely the reverse: European integration implies a uniformly raised overall level of governmental interferences with market operations, i.e. of economic disintegration; and the ECU means the substitution of bad monies circulating in smaller territories by a worse one circulating in all of Europe.

If European integration were really meant to widen markets, there would be no need for intergovernmental negotiations or agreements. This could occur at any time simply by refraining from any restrictions and regulations regarding the inflow and outflow of goods and services across state borders. Even if other governments did not follow a state's example, such a policy would invariably ensure the state's optimal economic integration and the level of wealth production and acquisition (such that any retaliation for another's non-free trade policies would not only harm foreigners, but invariably also inlanders).

Needless to say, unilateral free trade policies combined with attempts to convince others of the mutual advantage of following suit is not the integration course that governments of Western European countries have been taking during the last 30 some years. Revealingly enough, the one European country coming the closest to a policy of unilateral free trade, Switzerland, has never shown any serious interest in joining the European Community (nor does it plan to supplant the Swiss Franc by the ECU). Switzerland—small, multilingual, sparsely endowed by nature—has not only not suffered economically from this non-integration course, but has increasingly outdistanced its integrationist neighbors and could conceivably become the world's most prosperous country.

Instead, what the integrationist European governments have been up to from the very beginning is the multilateral negotiation of cartel agreements between agencies possessing the powers to tax and regulate distinct populations and areas. Naturally, it is against any such government's interest to enter an agreement that would imply a reduction of its own income. If agreements between governments are at all possible, they can only concern the coordination of measures designed to increase taxes and/or regulatory powers for all of the participating governments. In the field of regulatory action, in particular, this implies that agreements must typically involve compromising on the smallest common denominator such that if government A regulates matter X and B the matter Y, their "integration" then consists of A and B uniformly regulating X and Y. Such indeed are the major accomplishments of the European integration: the creation of a steadily growing and lavishly supported Eurobureaucracy in Brussels, Strasburg and Luxemburg in addition to or, most likely, equally increased national bureaucracies; the implementation of agricultural policies more absurd even than those of the United States, with mindboggling waste and pervasive corruption; the

unification of the tax structure through, for example, European-wide introduction of a value added tax (VAT), and numerous industrial regulations which will result in a general increase in discretionary governmental powers; massive interregional redistribution boondoggles; and ever increasing protectionist policies vis-a-vis 'outsiders' as the necessary complement of all of this 'integration.'

Similarly, if the European governments were really eager to create a better money, this, too, could be done unilaterally, in one stroke, and at any time. A government would only have to establish a free internal market for money and banking (that is, it would have to give up monopolistic central banking), and anything but 100 percent reserve (deposit-)banking would have to be regarded as incompatible with the rights of private property owners and thus fraudulent. There can be little doubt that under these circumstances gold, having historically demonstrated its status as a universal money, would quickly outcompete all other monies and emerge as the one commodity best serving the function of a common medium of exchange. A full-fledged gold standard would also be the optimal solution for any country desiring economic integration even if other governments were not likewise willing to abandon their practice of monopolistically controlled fractional reserve banking, because it would avoid the recurring cycles of malinvestments and subsequent liquidations necessarily associated with fractional reserve banking.

Naturally, no such thing has ever been the objective of the major European governments. With a system of central banking and a pure paper money standard in place, each government reaches complete internal autonomy for counterfeiting. That is, each is in the position to enrich itself at the expense of others simply by creating money out of thin air and buying real assets with such money. No government will ever deliberately sacrifice this magic wand. If there can be agreements between governments on monetary policy at all, it can again only concern an *increase* in each government's counterfeiting powers. And indeed, the European monetary integration policy, traditionally implemented through a system of 'flexibly fixed' exchange rates between national currencies (much like the present "snake"), has served precisely this purpose of enhancing the state's inflationary powers by agreeing with other monopolists on a policy of joint, coordinated counterfeiting.

However, this system is still unsatisfactory for each individual government because it cannot rule out that one currency may systematically depreciate against another, and hence that the power of one government will fall relative to that of another. The ECU and the plan to substitute it for the various national European currencies is the means for overcoming this obstacle. With the ECU established as the all-European paper currency, such relative depreciation is no longer possible within the entire territory of the European Community, and thus the new joint counterfeiting powers of all the involved governments are extended.

The idea of the ECU is not pushed for economic or other reasons that have anything to do with the com-

mands of a rational, universal ethic. On the contrary, it is advocated because it allows more inflation, more fraudulent income redistribution by all participating governments than even the present one, while it simultaneously aggravates the problem of cyclical malinvestments with subsequent recession periods.

There is another element that must be recognized if one is to fully comprehend the nature of European integration and the role of the ECU in this process. For while it is true that intergovernmental agreements can only concern a multilateral *increase* of the powers to tax, regulate, and counterfeit, and while European integration is indeed nothing but the establishment of an increasingly mighty cartel of governmental exploitation and expropriation, such a commonality of governmental interest is by no means sufficient to bring about an ultimate agreement between governments. Governments are competitors, too. In fact, their competition for exclusive control over territories and populations is by nature antagonistic. Yet as antagonistic competitors, governments face the same problem that any attempt to form a voluntary cartel faces. Any such cartel is doomed to fail, and not only because of the pressure exerted by the existence of other, non-member governments. In particular because of internal pressure, i.e. because of the fact that the governments which tax, regulate and counterfeit least and which accordingly can draw on more prosperous societies and to be the ones financially better off, are also those governments which have the least interest in complying with any cartel agree-

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**With the ECU established as the all-European paper currency, joint counterfeiting powers of governments are extended one step further.**

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ment. To be sure, their exploitative powers could surely increase with successful intergovernment cartelization. However, their power being relative to that of the competing governments would rise if they abstained from such a course of action and kept pursuing their policies of low level taxation and regulation and of hard money which made them the more successful governments in the first place. If instead they participate in an intergovernmental cartel, this implies benefiting less successful governments at their own expense.

Why in spite of these disincentives, has the West German government—the most economically advanced country among the major European nations and the one with the hardest currency (except for Switzerland)—played a leading role in the European integration process? The reason for this must be sought outside of Europe. The driving force behind the economic and monetary integration of Europe is the United States. It is the United States government that most wants it and has used its dominant position vis-a-vis the major Western European governments, and in particular West Germany, to make them overcome this disincentive and instead choose the course of cartelization they have actually taken. Without United



States government domination of relevant European governments the European "integration" process would have ended as quickly as and for the same reason that any strictly voluntary cartelization inevitably does.

With the end of World War II the United States government had established itself as the world's premier power, and in particular as the power that had acquired a status of military dominance over most of Western Europe. Formalized also in such later agreements as NATO, the United States relation vis-a-vis the major West European governments had become a hegemonic one. The United States troops and military installations that were and still are stationed all across Western Europe are the most vivid expression of the limited sovereignty of the major European governments. And all the while this hegemonic relation has been most pronounced with respect to West Germany, whose government to this day has not acquired even so much as a legalistic veil of sovereignty, but must openly and admittedly (if only reluctantly) conduct its affairs within the constant constraints of an enduring legal status of the United States military occupation.

Given this position of military dominance (which incidentally it could only achieve because it could draw on a relatively less taxed and regulated, and hence more prosperous society that must ultimately provide the economic resources necessary to secure military success), it has been only natural for the United States government to employ such power to its own economic advantage, i.e. in order to increase its own exploitative income from internal and external sources. Not surprisingly, it has served as the springboard for higher internal taxes for increased "defense" expenditures. But more importantly, beginning as early as 1944 with the Bretton Woods agreement, it has served as the means for implementing an international monetary system which established the United States dollar as the international reserve currency and arranged for a policy of coordinated inflation in the course of which the United States would set the pace in the process of governmental counterfeiting and the central banks of dominated foreign states would counterfeit on top of an inflating dollar. In this way the United States government's power to increase its own real income through counterfeiting fraud is effectively extended to foreign citizens; and simultaneously the inflationary potential of the entire participating banking system is systematically increased (which makes the dominated governments happy enough to console themselves with their somewhat limited sovereignty).

Such an arrangement is still unstable, in particular vis-a-vis economically highly developed countries such as those of Western Europe (and Japan), because it leaves ample room for the United States dollar to systematically depreciate against the currencies of such countries, which would eventually threaten the United States government's dominant position. For exchange rates are by no means exclusively determined by the inflationary policies of the various participating central banks. Ultimately they are determined by purchasing power parity. And even if a dominated state's central bank willingly inflates along with the dominating one's, then, other fac-

tors (such as a lower level of taxation and/or regulation) can still make its currency systematically appreciate against the dominant state's international reserve currency, which in time would tend to erode the latter's superior military position. Post-World War II development of West Germany and the German mark, and recently, Japan and the yen are notable examples for such growing "economic" threats to the United States hegemony.

From a status of military superiority, the effective promotion by the United States government of "integrationist" tendencies within regions of increasing economic strength, first and foremost in Western Europe, is the means for countering and possibly overcoming such dangers of relative power erosion, and of the constraints which they invariably impose on a state's internal powers of taxation, regulation, and counterfeiting. Left on its own the European integration process would have foundered because it works against the self-interest of the economically and financially most successful participant. However, for the United States government the cartelization

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### **European integration and establishment of the ECU mark an important step toward the ultimate goal of creating a one-world currency.**

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of the Western European power structure is of natural interest, precisely *because* it implies such a weakening of relatively stronger governments and currencies. The threat to the United States government and U.S. dollar supremacy is thereby reduced. At the same time, by lending active support to an integration process that means European-wide increased levels of governmental taxation, regulation, and paper money creation (and that is thus bound to assure the happy cooperation of all participating governments, including that of West Germany, obviously the relative loser in this scheme, yet also the one whose sovereignty is most severely limited), additional room is created for the expansion of the United States government's internal powers of exploitation. Finally, European integration and the ECU mark an important step toward the ultimate goal of creating a one-world paper currency, and a worldwide unified and harmonized tax-regulation structure administered by a United States dominated world bank and government that at last would get rid of all external, competitive obstacles to counterfeiting, taxing and regulating. With the European integration near completion, the next foreseeable step in this direction will be increased by United States efforts to 'integrate' the Pacific region, with Japan destined to play a role similar to that of West Germany on the Atlantic side.

All this has nothing to do with operation of free market forces. Rather than being an extension of free markets and a better media of exchange, it is the extension of United States imperial power, of a dollar imperialism built on top of it, and of intergovernmental cartelization with worldwide increased levels of taxation, regulation, and in

particular paper money inflation.<sup>1</sup>

<sup>1</sup>For a fuller treatment of these and related matters see my "Banking, Nation States, and International Politics," *The Review of Austrian Economics*, Vol. IV (1989) (forthcoming) and "Marxist and Austrian Class Analysis," in: Llewellyn H. Rockwell, Jr. (ed.), *Marxism: Economics, Religion, Politics, and Philosophy*, Auburn, Alabama: Mises Institute (forthcoming 1989).

Hans-Hermann Hoppe is associate professor of economics at the University of Nevada, Las Vegas, and a senior fellow of the Mises Institute. He is a frequent lecturer at Mises Institute conferences. ■

**A Theory of  
Socialism and  
Capitalism**

Hans-Hermann Hoppe

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INSTITUTE

*Professor Hoppe's most recent book, A Theory of Socialism and Capitalism (Kluwer Academic Publishers) is available from the Mises Institute; \$45.00 hardback.*

## University of Nevada, Las Vegas To Offer Masters Program in Austrian Economics

by Amy Marshall

The economics department at the University of Nevada, Las Vegas, has recently received approval for the creation of a new concentration in Austrian economics within the Theory and Policy track of the Masters of Arts Program. The economics department over the past several years has been committed to growth and expansion and Austrian economics has been a major focus of that expansion. With Professor Murray N. Rothbard and Professor Hans-Hermann Hoppe on the faculty, in addition to the promotion of Professor Roger Arnold as department head, gives a solid base for this new program.

The proposed Austrian economics concentration will have three core courses. Course titles and descriptions are in the process of being formalized. In addition to these core courses now under consideration, there will be 30 hours of required electives and then comprehensive exams or a thesis. Most of these existing electives can be taken from the Austrian faculty and it is also possible to have Austrian representation on the exam or thesis committee.

The economics department is vibrant and growing. The faculty of more than 15 is rather eclectic, with no overriding solidarity other than that found among those interested in Austrian economics. All the students are

heartily encouraged to pursue their chosen areas of concentration, whether applied or theoretical. A new departmental colloquium, which begins next term, will provide a bi-monthly forum for presentation and discussion of the research being done within the department as well as diverse topics of interest.

Two of the university's research centers are specifically dedicated to the study of economics. The Center for Business and Economic Research matches the skills of economics faculty and research assistants with the needs of the local business community by providing surveys and market studies. The Center for Economic Education is part of a national network of 20 centers that aim at improving the quality and quantity of economics taught at all levels. Both of these centers provide a potent source of employment for graduate students.

The university as a whole is also in a period of expansion. It has an enrollment of over 14,000 students on a 335-acre campus located just a few miles from the big hotels and bright lights of the Las Vegas casinos; while being only five hours from Los Angeles.

While UNLV may not have crossed many minds as a place to pursue advanced studies in economics, it should now be seriously considered by any student wishing to take advantage of a course of study emphasizing the Austrian school. It is also a rare opportunity to be able to study and interact with several of the foremost scholars in Austrian economics today.

Anyone interested in obtaining more information about the existing economics program and/or the newly created concentration in Austrian economics should write directly to the economics department: Economics Department, University of Nevada, Las Vegas, 4505 South Maryland Parkway, Las Vegas, Nevada 89154. ■

Amy Marshall is a Mises fellow and graduate student in economics at the University of Nevada, Las Vegas.



*The University of Nevada, Las Vegas.*

## "Keynes and Keynesianism"

April 28 - 29, 1989

Gutman Conference Center  
at Harvard Square  
Cambridge, Massachusetts

### A History of Anti-Keynesian Doctrines

*Mark Skousen*

### The Philosophical Foundations of Keynesianism

*David Gordon*

### Income-Expenditure Analysis and the Chicago School

*Roger Garrison*

### Keynesians and Neo-Keynesians

*Don Bellante*

### John Maynard Keynes vs. Ludwig von Mises

*Hans-Hermann Hoppe*

### Modern Myths of Keynesian Economics

*Jeffrey Herbener*

### Keynes and the Anti-Savings Mentality

*Mark Skousen*

### Keynesianism and World Inflation

*Joseph Salerno*

### Keynes the Man: Hero or Villain?

*Murray Rothbard*

For more information and details contact Pat Heckman at The Ludwig von Mises Institute, Auburn University, Auburn, Alabama 36849

## "Marx and Marxism: Economics, Religion, Politics and Philosophy"

by Jeffrey A. Tucker

It is a sobering thought that Marxists still greatly outnumber Austrians in the economics departments in American universities. Most major philosophy departments contain one or more token Marxist professors. Marxism is actually *gaining* in respectability within departments of religion (and in many pulpits, too) through studies in "Liberation Theology." Within the modern literary establishment, Marxist class-war analysis has replaced reconstructionism as the dominant paradigm. Leaving aside the question of whether a shift from irrationalism to polylogism is progress, the last time class-war models dominated literary criticism was in the early thirties.

As a response to this, it was appropriate that the Ludwig von Mises Institute called an interdisciplinary meeting to assess the state of Marxist ideology today: "Marxism: History, Philosophy, Religion, and Economics," October 15-16, 1988 at the St. Moritz Hotel in New York City. The attendance was high, the discussion was lively, and the papers were rigorous and diversified.

Professor Murray Rothbard, of the University of Nevada, Las Vegas, presented his paper on "Marx as a Christian Heretic." Rothbard connected Marx's theory of the direction of history with that of medieval Christian heresies which made no Creator-Creation distinction and taught that history was in the process of unifying God and Man into one being. Dr. David Gordon, a philosopher and senior fellow of the Mises Institute, spoke on the "Foundations of Marx's Philosophy and Economics," in which he traced Hegel's thought in Marx and showed it to be riddled with confusions.

Professor Ralph Raico, a historian from the City College of New York, in his paper "The Classical-liberal Roots of Marxist Class Analysis," presented the thesis that the French classical liberals were precursors to Karl Marx in the theory of social conflict. Professor Hans-Hermann Hoppe, an economist and social theorist at the University of Nevada, Las Vegas, spoke on "Marxist and Austrian Class Analysis," in which he listed the ways Marxists perceive social patterns in the market which actually apply to the state.

Professor Richard Ebeling, an economist at Hillsdale College, spoke on "Eugen von Boehm-Bawerk's Critique of Marxism," to remind us that it was this famous Austrian economist who refuted the Marxist theory of exploitation by exposing its numerous contradictions and fallacies. Dr. Gary North, economist at the American Bureau of Economic Research, spoke on "The Marx Nobody Knows," in which he gave some revealing details about Karl Marx's high personal income, and lavish spending habits. Professor David Osterfeld, professor of philosophy at St. Joseph's College, spoke on "Marx and Mercantilism," showing the affinities between the two and their doctrines regarding free exchange. Finally, Dr. Williamson Evers, a political scientist at the Hoover Institution, delivered "Marx and the Organization of Labor Under Socialism," showing how Marx did not intend for the laborer to ultimately have the freedom to choose his own profession, to change jobs, negotiate his salary, etc.

The papers from this conference will be collected into a book to be edited by Llewellyn H. Rockwell, Jr., and published by the Ludwig von Mises Institute. ■

If you would like to submit an article, book review, or an item to the "Notes and Transitions" column, please send it to :

Mark Thornton, Editor  
*Austrian Economics Newsletter*  
Ludwig von Mises Institute  
Auburn University  
Auburn, Alabama 36849

## Book Bites

### *The Gold Standard in Theory and Practice* Edited by Barry Eichengreen Methuen, 1985

Like most collections of articles on monetary reform, the editor's introduction points to the problems of the current system and the urgent need for reform. Barry Eichengreen, professor of economics at Harvard, thinks the biggest problems arise from the current "destabilizing" system of floating exchange rates. Under this system, "governments" find "themselves chronically unable to coordinate policies with one another." The gold standard is one way of fixing the problem, because its primary virtue is "its association with exchange-rate stability," which, he correctly points out, can be achieved with or without gold. There is "no explanation" at all for other benefits that may be associated with the gold standard, like, for example, its ability to control inflation and restrain government interference. "Resurrecting the gold standard," therefore, "would involve significant costs, serious uncertainties, and dubious benefits."

The rest of the volume is an assemblage of articles designed to bolster the original themes in his introduction. They range from David Hume's discussion of specie-flow model (1752), to Robert Barro's discussion of price levels under gold (1979), and to Richard Cooper's attack on the Rothbardian 100 per cent gold coin standard and similar proposals. Also included are articles by P.B. Whale (1937), Donald McCloskey and J.R. Zecher (1976), W.M. Scammell (1965), Robert Triffin (1964), A.G. Ford (1960), Ragnar Nurkse (1944), Milton Gilbert (1968), and two crucial governmental reports on the monetary system from 1918 and 1931. The wide range of articles makes this a crucial series of readings for anyone interested in the future of the world monetary system.

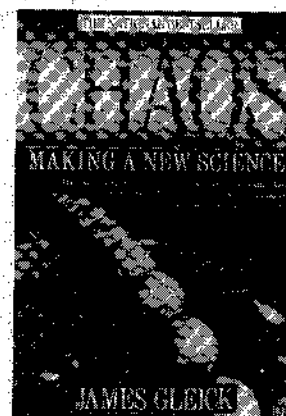
Richard Cooper, an advocate of a single world fiat currency issued by a world central bank, aims his arguments at several pro-gold bills that appeared in Congress. It is unwarranted, he says, that "these proposals are being treated with a seriousness that would have been astonishing twenty, ten, or even five years ago." The dollar cannot be defined in terms of gold because there is "too little gold" to cover all the dollar deposits; and if their price were set high, he fears "large-scale dishoarding." Further, Cooper argues that if government "experts" cannot manage discretionary monetary regimes, neither would they be wise enough to implement and operate a non-discretionary one. If the government experts don't want discretion, they don't have to use it, regardless of what the monetary constitution looks like. That's an interesting point, but it trivializes the basis of all constitutional restraints against government action; like many other writers represented in this volume, he takes no account of the disharmony of interests between the government and the market. JAT ■

### *Chaos: Making A New Science*

By James Gleick  
Penguin Books, 1988

Chaos theory is a new approach in mathematics that has important implications for physical science, social science, and the methodology of scientific inquiry in general. James Gleick, an editor and reporter for the *New York Times*, provides a readable and interesting account of the historical development of this new field in mathematics and its implications, with several references to economics.

The traditional use of mathematics in many fields has been limited to calculus and simple geometry. The use of continuous functions allowed for the existence of solutions, and the use of simple figures allowed for measurement. Complex models have been built where only linear equations were used, because this was thought to be a



reasonable approximation to the real world. When real-world data did not conform completely to predictions, this was attributed to random "noise" or "shocks".

But then scientists discovered that even very simple models containing nonlinear terms (surely a more realistic description of reality, in economics as in other disciplines), exhibited very complex behavior. In particular it was discovered that small differences in initial conditions may result in large differences in the path taken by a model, making the prediction of future states impossible. Taking the concept of "sensitive dependence on initial conditions" to its extreme, chaos theorists coined the term *Butterfly Effect*: the notion that a butterfly flapping its wings in Brazil may cause major climatic changes in the United States.

The level of abstraction and sophistication of chaos theorists dwarfs that of yesterday's mathematical economics. Complex behavior in the real world implies complex causes, yet in chaotic models simple equations can generate very complex behavior. As the author notes, economists study the most elusive creature of all, and they have borrowed tools from the physical sciences which are largely inappropriate to the pursuit of knowledge in their field.

Chaos theory has allowed physical scientists in such diverse fields as geography, meteorology, electronics and seismology to handle real-world phenomena previously thought to be completely random or too complex to understand. A recent program on PBS illustrated how the behavior of the human heart going into fibrillation or the

turbulence generated in fluids being heated can both be shown to have a "chaotic" dimension.

But chaotic behavior is still a sub-species of deterministic behavior, and the question remains whether deterministic models, linear or non-linear, are appropriate for the understanding of macroeconomic events. In the best tradition of positivist science, economic researchers are currently investigating whether such time series as stock market prices can be shown to be chaotic. It has yet to be proven whether the discovery that this is so will lead to better macroeconomic models or better economic policy.

It is not yet clear what impact the new field of chaos theory will have on economic science. It seems clear that if the economy can in fact be reasonably described by a set of nonlinear equations, so that the macroeconomic variables can be expected to behave "chaotically," then economists may have to give up such standard tools as the assumption of perfect information, the perfect-market hypothesis, statistical forecasting, and the notion that computers can somehow overcome the problem of socialist calculation.

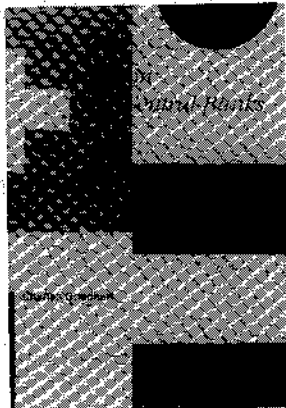
It remains to be seen whether such a development would lead economists to abandon their positivist methodology and their use of mathematical modelling, or if chaos theory is simply the next step in the takeover of economics by mathematics. MT

## ***The Evolution of Central Banks***

By Charles Goodhart

MIT Press, 1988

Most of us are familiar with arguments for the evolution of law, language, money, and morals. Who could have imagined a case for the evolution of central banks—the institution which has bloodlessly and imperceptibly though steadily transformed free societies into essentially planned economies? In *The Evolution of Central Banks*, Charles Goodhart mounts a brief but startling historical defense of the fact that "the role and functions of Central Banks have evolved *naturally* over time, and play a necessary part within the banking system."



Central banks perform a macro function of discretionary monetary management through open and foreign-exchange market operations and by setting reserve requirements. However, Goodhart defends only the evolution of central banks' micro functions—acting as a lender

of last resort and regulating and supervising the banking system. Historically, in developed financial systems these micro functions were performed by either large commercial banks or private clearinghouses. But this type of market arrangement could not last, Goodhart argues, primarily because of the conflict of interests—profit-maximizing banks or clearinghouses dominated by large banks could not be impartial in helping their illiquid competitors. Out of this conflict of interest, nonprofit-maximizing, noncompetitive lenders of last resort—central banks—were the natural outcome. To perform the lender-of-last-resort function responsibly and avoid hazardous moral problems, the central banks had to undertake supervision and regulation of the banking system.

Though the book's theoretical arguments against free banking and private deposit insurance leave much to be desired, the illustration of the arguments with varied historical episodes is illuminating. The 56 page appendix on "Central Banks in Europe and Japan at the End of the Nineteenth Century" will be of great interest to students of the history of banking. PJS

## ***The Money Doctor in the Andes: The Kemmerer Missions, 1923-1933***

By Paul W. Drake

Duke University Press, 1989

Paul Drake has done excellent detective work in piecing together this episode from the career of one of the most important economic consultants of all time. The "Money Doctor," Edwin Walter Kemmerer, was a technocratic economist from Princeton University who served as editor of the *American Economic Review*, and President of the American Economic Association. However, he is most famous for his efforts as a consultant to foreign countries and as one of the organizers of the Federal Reserve System in 1911, not for his theoretical contributions.

At the suggestion of the United States State Department, Kemmerer began a career as a consultant to foreign governments, suggesting the implementation of central banking, the supervision of the banking industry, and the use of a national comptroller. During his long career he worked for and advised many foreign governments, Drake however concentrates on Kemmerer's assignments in Columbia, Chile, Bolivia, Ecuador, and Peru. These countries eagerly adopted Kemmerer's recommendations in order to gain access to foreign loans. Kemmerer was able to place American bankers on the board of directors of foreign central banks, and his missions to South America proved to be a low cost method of American hegemony.

When the Great Depression finally hit, Kemmerer's policies were dismissed, but the institution of central banking remained to become an engine of inflation. South American countries defaulted on their loans; loans made possible by Kemmerer's seal of approval. These loans went almost entirely to governments: increasing state activism, improving the governments' ability to collect taxes, and increasing the power of the executive over the legislative branch of government.

Drake admires Kemmerer's success as a consultant and defends his objectivity, but is forced to admit several damaging facts. For example, a large bond dealer who profited from selling foreign government bonds to American citizens endowed Kemmerer's chair at Princeton. He also helps expose Kemmerer's inconsistency by noting that Kemmerer was an anti-inflationist, a believer in the gold (exchange) standard and laissez-faire. Drake also draws some interesting parallels between Kemmerer in the 1920s and some University of Chicago economists during the 1970s, as well as between the South American defaults in the 1930s and 1980s. MT ■

## ***America in the World Economy: An Agenda for the 1990's***

**By C. Fred Bergsten**

**Institute for International Economics, 1988**

This new book by C. Fred Bergsten is written for "those who will be managing and influencing the international economic policy of the United States from January 1989 until well into the next decade." That's why this book was released on November 9, 1988, the day after Bush was elected president. And given the Institute for International Economics' influence in Washington, this book is very important.

"The globalization of markets has outrun the ability of governments to cope," says Bergsten. His answer to this is more government-to-government collusion in order to better manage the economy—"active international policy cooperation." The first priority, he says, is "the creation of a more effective monetary regime" because the current "nonsystem" has "fostered huge currency misalignments" and "generated economic distortions." He praises the Reagan administration's efforts of "groping toward a new system" where central banks would agree to buy and sell each others' currencies according to prearranged schedules, as was worked out at the 1985 Plaza Agreement and later in the 1987 Louvre Accord. Bergsten suggests "completing the process" through requiring "major countries to work out the details of a system of target zones" for currency movements, which would "provide a strong foundation for improving international coordination of national economic priorities."

He insists that "the dollar must come down by another 15 to 20 percent [in real terms] to achieve the needed adjustment." To prevent a "hard-landing" he proposes that the U.S. dollar depreciate "in tandem with proposed macroeconomic changes in the United States and abroad": 1) a big increase in government spending (to "increase GNP"), 2) an imposition of consumption taxes (to "eliminate the budget deficit"), and 3) an increase of income redistribution from the West to "15 heavily indebted countries of the Third World." He suggests an increase in World Bank lending from \$15 billion to \$25 billion. He wants the InterAmerican Development Bank's lending to double from \$3 billion to \$6 billion. The IMF, he says, should "double" its lending. This would increase the total U.S. foreign aid and lending package by \$200 billion. "A renewed role" for these institutions "should be

a major objective of the foreign economic policy of the new administration." He also proposes more centralization of government power into the hands of the executive branch and a diminution of the Congressional role in making economic policy.

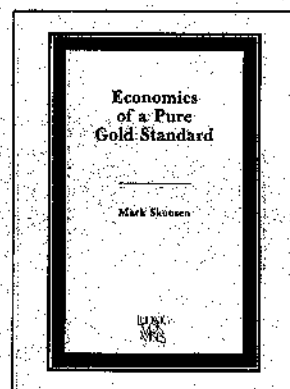
This book is the antidote for those who say that the expansion of global markets is necessarily bullish for free markets (e.g. George Gilder). It shows that this optimism should be tempered by the prospect of globalized government control. JAT ■

## ***The Economics of a Pure Gold Standard***

**By Mark Skousen**

**The Ludwig von Mises Institute, 1988**

The prospects for a gold standard are dismal because of the barriers erected by pressure groups and special interests, which includes the Federal Reserve, the big banks, the Treasury, much of Wall Street, and Washington's political establishment. Yet Mark Skousen thinks the potential benefits of a pure gold standard make it a cause worth pursuing. By "pure" gold standard, Skousen means a monetary system wherein 1) dollars are defined in terms of a weight of gold, 2) prices are expressed in terms of gold dollars, and 3) all paper currency and bank deposits have 100% gold backing.



The economic benefits of the pure gold standard include smoothing trade cycles, eliminating inflation and currency debasement, limiting prospects for government manipulation, and lowering interest rates. Skousen highlights the history of the gold standard from the 7th century B.C. and traces monetary developments to modern times.

Perhaps the most valuable feature of this book is its highly concise summary of the four major monetary systems: the 100% specie standard, free banking, fiat fractional reserve banking (the current system), and 100% fiat standard. He lists the key characteristics of each, the role of government, advantages (as seen by advocates), disadvantages (as seen by critics), practicality of the system, and major figures supporting each one. Also useful is his discussion of the differences between the 100% gold standard and the "free banking" position, widely regarded as the "second best." Skousen thinks there is no reason why the gold standard and freedom in banking aren't compatible, so long as fraud and embezzlement statutes are upheld. GBL ■

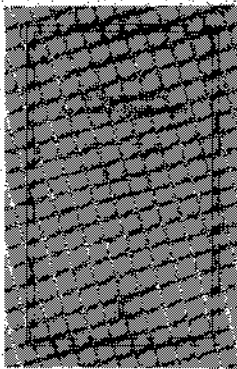
**Ludwig von Mises:  
An Annotated Bibliography**

By David Gordon

The Ludwig von Mises Institute, 1988

This bibliography is an immensely helpful research tool and the first substantial bibliography since Bettina Bier Greaves published *The Works of Ludwig von Mises* in 1969. It tracks Mises's writings from his earliest work in Austria, the first being a 1902 seminar essay, "dealing with the decline of serfdom in Galicia," as Gordon annotates. The last entry is his recently published remarks from 1962.

Gordon's annotations give clear and unbiased presentations of the thesis, organization, and highlights of the books, articles, and reviews. For example, Gordon summarizes an article Mises wrote on expectations, appearing in *Economica* (1943) in the following way: "Mises does not consider it a good objection to the Austrian theory of the business cycle that businessmen perhaps will not lengthen the structure of production if bank credit expands. If they do not, the business cycles will not start—but the aim of economics is merely to explain those cycles that do occur."



The other annotations are equally lucid. The length of each ranges from one to two pages for his major books *Socialism* and *Human Action*, to one sentence for minor articles. The compilation also brings to the forefront many unknown articles, some of which have yet to be translated into English. The bibliography contains a separate alphabetical listing of Mises's works and an index to the publication itself. We can hope that this is the precursor to the *Collected Works of Ludwig von Mises*, but in the mean time no scholar interested in Austrian economics can afford to be without this guide. JAT ■

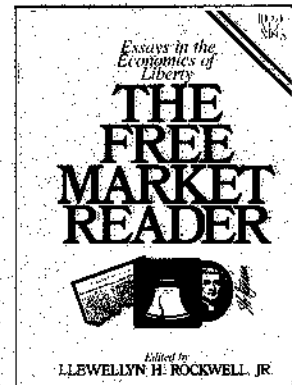
**The Free Market Reader: Essays in  
the Economics of Liberty**

Edited by Llewellyn H. Rockwell, Jr.

The Ludwig von Mises Institute, 1988

Mises Institute president Lew Rockwell has put together this collection of essays from *The Free Market*, the institute's policy newsletter. Designed as a popular introduction to Austrian views on government and the economy, *The Free Market Reader* contains over 70 brief items, fully indexed and organized into eight sections ranging from "Fundamentals" and "Great Economists" to "Fiat Money

and the Gold Standard," "Free Trade and Protectionism," and "Privatization versus Government Ownership." There are contributions from Free Market regulars Rothbard, Rockwell, Hoppe, Mark Skousen, and others, and some pieces by "fellow travelers" like Tom Bethell (*The American Spectator*) and Robert Higgs (*Crisis and Leviathan*). Other welcome additions include a condensed version of Mises's "Liberty and Property" and "A Call to Activism" from Mrs. Margit von Mises. Among other highlights are: Rothbard's "Ten Great Economic Myths," perhaps



the most worthwhile fourteen pages you can send to your Congressman; Rockwell's highly-popular "A Plague from Both Their Houses: The Economic Advisors to Bush and Dukakis"; Skousen's accessible "Understanding the Austrian Theory of the Business Cycle"; and the typically irrepressible Walter Block ("The Case for a Free Market in Body Parts"). The five essays on Reaganomics are sure to raise a few Conservative eyebrows.

In short, *The Free Market Reader* makes a fine introduction to Austrian-style policy prescriptions for the interested layman and the undergraduate student confined to the world of the run of the mill economics textbook. In the tradition of Ludwig von Mises's *The Anti-Capitalistic Mentality* and Rothbard's *What Has Government Done to Our Money?*, these essays should go a long way toward disseminating the Austrian outlook to the general public. Haven't the Samuelsons and Friedmans monopolized the *Newsweek* columns long enough? PK ■

**Praxeology and Economic Science**

By Hans-Hermann Hoppe

Praxeology Press, 1988

This monograph by one of the new faces in Austrian circles addresses the question of methodology in economics and the basic differences between Austrians and other economists. The monograph is based on Professor Hoppe's lectures on methodology at the Mises Institute's 1987 instructional conference at Stanford University.

Professor Hoppe begins by defining the typical Austrian method and noting the responses to it by "mainstream" economists. He shows that the method developed by Mises was actually the mainstream methodology until the middle of this century, and that Mises "only" made this methodology rigorous, and well-defined. Kantian philosophy, Mises's improvements to it, and the basic chain of economic reasoning are outlined for the reader.

Many errors and contradictions of empiricism, the

dominant methodology in economics (although largely ridiculed in other academic areas), are exposed here. The separation of theory and history, the folly of forecasting, and the scope of praxeology are dealt with in a straightforward, realistic, and concise manner. While this monograph may not be the final word on methodology, it is nonetheless one of the best instructional tools on methodology to date. MT

## Notes and Transitions

The annual meeting of the Southern Economic Association was held in San Antonio, Texas and was well-attended by Austrian economists. However, there were no sessions on Austrian economics or related topics.

The annual American Economic Association meeting was held this year in New York City. A session entitled "Intersections between Monetary Theory and Microeconomics" was organized by Leland Yeager, the Ludwig von Mises Distinguished Professor of Economics at Auburn University. It featured papers by Don Boudreaux of George Mason University, Roger Koppl of Fairleigh Dickinson University, and George Selgin of the University of Hong Kong. Boudreaux reconsidered the doctrines of Henry Simons, on the founding of the Chicago School of economics. He showed how Simons, unfortunately, did not follow through with his renowned advocacy of rules versus authority in monetary policy into the realm of industrial organization and antitrust policy; Simons' activist position in that realm revealed a failure to grasp decisive Austrian insights.

Roger Koppl, drawing on methodological teachings of the late Fritz Machlup, argued that the apparent erratic behavior in sensitive markets such as the foreign-exchange market stems largely from the presence of "big

players," notably governments, and from changing conjectures about what their policies might turn out to be.

George Selgin, drawing on almost forgotten writings of several decades ago, adding new insights of his own, launched a reexamination of whether stability of the price level is a proper criterion of monetary institutions and policies.

The discussants for the session were Mark Toma (Miami University of Ohio), David Tuerck (Suffolk University, Boston) and Warren William Woolsey (The Citadel).

Five articles from previous issues of the *Austrian Economics Newsletter* will appear in *The Austrian School of Economics*, a three volume project edited by Stephen Littlechild which will be included in the series *Schools of Thought in Economics* edited by Professor Mark Blaug to be published by Edward Elgar Publishing. The five articles are: Richard Ebeling, "On the Theory of Costs," 1, No. 1 (Autumn 1977); Hans-Hermann Hoppe, "The Justice of Economic Efficiency," 9, No. 2 (Winter 1985); Murray Rothbard, "Adam Smith Reconsidered," 9, No. 1 (Fall 1987);

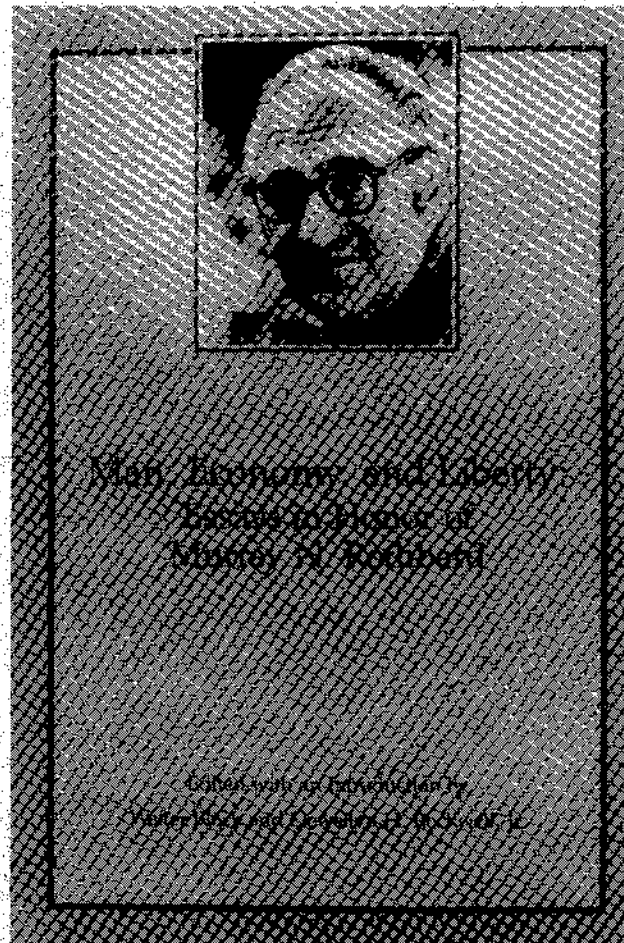
Joseph T. Salerno, "The 'True' Money Supply: A Measure of the Supply of the Medium of Exchange in the US Economy," 6, No. 4 (Spring 1987); and Lawrence H. White, "Comment on Shackle's Notion of Opportunity Costs," 1, No. 2 (Spring 1978).

Robert B. Ekelund, Jr., a member of the editorial board of the *Review of Austrian Economics*, was named the Edward L. and Catherine K. Lowder Eminent Scholar at Auburn University.

William H. Peterson will return to Campbell University as the Lundy Professor of Economics.

Basil Blackwell has announced a new journal, *Economics and Politics*, to be edited by Jagdish Bhagwati of Columbia University, and published three times a year. The journal will focus "on analytical political economy, broadly defined as the study of economic phenomena and policy in models that in-

clude political processes. Intellectual history and creative writings at broader levels, as distinct from theoretical and econometric analyses, will be included from time to time."



Man, Economy, and Liberty: Essays in Honor of Murray N. Rothbard is now available from the Mises Institute: \$23.00 paperback and \$45.00 hardback.