

AFTER THE AGE OF INFLATION: AUSTRIAN PROPOSALS FOR MONETARY REFORM

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If economic events of the last 30 years imply anything, it is the urgent need for monetary reform. The international monetary system, degrading since the classic gold standard of the nineteenth century, which itself was less than ideal, reached its nadir with the collapse of the Bretton-Woods regime in the late 1960s. When President Nixon closed the gold window in 1971, he hastened the world down the path of monetary disintegration. “Freely” fluctuating currencies not only failed to establish international economic prosperity on a firm foundation, but aggravated instability by unfettering the forces of monetary inflation. Unbound by reserve drains and periodic devaluations caused by excessive monetary inflation under Bretton-Woods, central banks began a world-wide monetary inflation unprecedented in peacetime.

Whatever hopes were raised that all this would change with the reconstruction of an international dollar-reserve system in the 1980s, they were dashed when the world’s new monetary order failed to halt the retrogression and seems, in fact, to have given the world more, not less, instability. The Japanese attempt to reestablish its pre-Second World War regional dominance in East Asia by instigating a yen-based economic boom in the second half of the 1980s came up short after the collapse of the American stock market and consequent reversal of the American weak-dollar policy. The subsequent strong-dollar policy concentrated on encouraging a steady build up of foreign dollar holdings. Unable to compete with the dollar as a reserve currency in East Asia, the yen collapsed under the weight of the previous yen inflation. Higher Japanese interest rates and the recognition that the 1980s credit expansion had fostered serious malinvestments in the Japanese economy led to its awesome stock market crash. By preventing liquidation of the malinvestments of the boom, especially in the banking sector itself, the Japanese government has generated an economic stagnation in Japan now well into its second decade. Spurred on by the energetic absorption of dollars in East Asia, Mexico, South America, Eastern and Central Europe, and Russia throughout the 1990s, the Federal Reserve inflated the

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dollar stock at accelerated rates. The resulting malinvestments of the credit-expansion boom occurred outside America in the first half of the 1990s. Adding to the problems of those countries that had pegged their currencies to the dollar in the new dollar reserve system was the inflation of their domestic currencies in excess of the build up of their dollar reserves. The pegs broke, first in Mexico, then in Russia, Southeast Asia, Eastern and Central Europe, and South America. Along with currency debacles in these countries came the concomitant domestic price inflation, rising interest rates, collapsing financial markets, and economic liquidation. Having ravaged that part of the world economy outside the U.S. on the dollar-reserve standard, the Federal Reserve dollar inflation hit home in the latter half of the 1990s. Domestic credit expansion began in earnest in 1995 and built to a crescendo in 2000. Since then the Dow Jones Industrial Average has fallen nearly 40 percent and the NASDAQ by nearly 80 percent. The liquidation is well underway with no end in sight. Certainly it is no exaggeration to say that recent events have demonstrated the bankruptcy of the international monetary system.

Given this state of affairs, one of the most valuable tasks economists can perform today is to advance proposals for monetary reform. Hans Sennholz, then, must be considered preeminent, having devoted the better part of his long and distinguished academic career to post-Second World War monetary reform. From his earliest writings on the subject, in 1955, Sennholz realized its importance. He wrote:

The return to sound money policies is of utmost importance. Without sound money there can be no economic recovery, no prosperity, no economic cooperation, no international division of labor, no unification. Sound money is the cornerstone of individual liberty. Sound money is metallic money. It is the gold standard. (Sennholz 1955, p. 296)

More than merely understanding the importance of monetary reform to the world, Sennholz clearly grasped what the goal of reform must be.

AUSTRIAN MONETARY THEORY

Sennholz could reach this apogee because he eagerly embraced the Menger (1976)-Mises (1980) theory of money. Concerning monetary reform, their key insight is that money is organic to the market economy. It is part and parcel of the private property, voluntary exchange order. State intervention, therefore, is unnecessary for money to originate, develop, and reach its most advanced state. A medium of exchange must have originated as a widely traded commodity exchanged on a well-developed barter market. Only under such conditions would indirect exchange prove beneficial to traders in facilitating their trades by increasing the instances of reverse preferences among them. Money can never originate by state fiat because a new fiat money is not a traded item, hence: it cannot serve as a medium of exchange. All the state can do by fiat is ratify an existing medium of exchange as money. Moreover, because it is not being traded, a newly issued fiat money lacks exchange value, by which traders can use arithmetic computation to determine how much of it to give and accept in exchange for goods and factors. For something that is not being traded on the market to become a medium of exchange, it must be introduced as a money substitute, i.e., as a legal claim to money that is redeemable for money at par on demand. As a substitute for money, it assumes the medium of exchange function and the exchange value of money itself. On the exact nature of the legal claim by which something becomes a money substitute, Austrian scholars disagree and their disagreement gives rise to different proposals for monetary reform which will be examined below. What they do agree on is that the private issuer of a money substitute cannot legally rescind redemption permanently and thereby transform the money

substitute into money itself. Only the state can violate private property with impunity and thereby transform a money substitute into fiat money by abrogating its redemption claim permanently.

Over time, traders give up commodities less suited to perform the medium of exchange function for those better suited for this task. The superior durability, divisibility, portability, and relative stability of the exchange value of gold and silver give incentive for traders to adopt them as money to the exclusion of other commodities. A monometallic standard is unlikely, without state intervention to demonetize either gold or silver, because of the differing exchange value between gold coins and silver coins. Gold's high value to weight ratio makes it impractical to mint gold coins small enough to use for low-priced items. Instead traders would use gold coins for higher-priced items and silver coins for lower-priced ones. The production of coins would be regulated by profit and loss on the market just as the production of any good is so regulated. If demand for gold and silver coins increased enough to raise their purchasing power above the costs of their production, then minting companies would produce more. Their added production would push the exchange value of money down, their added demand for the factors of production would push factor prices up, and their added capital investment would push rates of return down until the greater profitability of expanding operations no longer persisted. Money substitutes would be demanded by traders seeking a medium of exchange having greater convenience and safety than coins. To the extent that they were willing to pay fees high enough to cover the costs of producing the money substitutes, banks would provide them. Because the cost of providing money substitutes would be nearly the same regardless of their denominated value, only the demand for larger denominations would likely be satisfied. But if demand were great enough for small denomination money substitutes so that they displaced silver coins, then a gold standard could emerge as the monetary regime freely chosen by traders in the market. In short, the monetary system of the market economy, one in which money and money substitutes are part and parcel of the market itself, would be a commodity standard, either gold coins or gold and silver coins as money and perfectly redeemable money substitutes.

Within this basic framework, Austrian authors differ on two points.¹ One is the identity of the money producer. Some rest content with having the state produce money, while others argue that only production by private enterprise is consistent with the market economy. Hayek (1976, pp. 42-46, and 99-101) would permit the state to continue issuing fiat paper money denominated in dollars in competition with private producers of fiat paper money denominated in their own, freely chosen, units such as "ducats." Some of the modern free-banking school would also retain state issued fiat paper money, as long as its stock was kept constant and used almost exclusively for bank reserves (Selgin 1988, pp. 167-68; White 1989, p. 14).² Like Hayek, Sennholz (1985, pp. 77-83) advocates competition in money production, but with private enterprises providing gold coins and the state issuing fiat paper money, and counsels moving directly to a competitive market by rescinding legal tender laws and other legal obstacles to private money production. Ludwig von Mises would go further in purging the state from the monetary regime. He would merely permit it to operate a "conversion agency" that would mint privately produced gold and silver into coin and convert its redeemable paper money substitutes into coin on demand at par

¹Save Hayek, all of the Austrian economists surveyed accept the basic framework established by Menger. See Mises (1980, pp. 41-49); Rothbard (1983, pp. 8-13); Sennholz (1992, pp. 19-34); and White and Selgin (1989, pp. 218-21).

²Selgin (1988, p. 171) contends that money proper need not be government issued fiat paper, but could be gold or fiat paper produced by private enterprise. White (1989, pp. 161-63) asserts that almost anything could be used as money proper.

(Mises 1980, pp. 487-88 and 492-94). Only Murray Rothbard insists on the goal of complete private enterprise production. His ideal is a pure gold standard. He would do so through the intermediate steps of restoring the redemption of the dollar into gold and dissolving the Federal Reserve System. Having privatized the state's gold stock, private enterprise would then mint coins and issue money certificates (Rothbard 1994, pp. 146-51).

The second point on which these authors have differing views is the nature of money substitutes. The modern free-banking school claims that the issue of money substitutes, whether money certificates or fiduciary media, is an exercise of the right of freedom of contract and that this right extends to the issue of money substitutes for which the obligation of redemption can be temporarily rescinded by the insertion of an "option clause" into the contract for the money substitute (Selgin 1988, pp. 31-32, 137, and 161-62; White 1989, pp. 157, 235-36, and 246). Mises and Sennholz take the position that issuers do not have the legal right to issue fiduciary media, *per se*, but only perfectly redeemable money substitutes.³ To be a medium of exchange, any money substitute, whether money certificate or fiduciary media, must be redeemable for money on demand at par. As Sennholz wrote:

The issuers of money substitutes, whether private or public, keep their currencies at par with gold through unconditional redemption. A note-issuing bank buys any amount of gold against its currency or deposits at the parity rate, and sells indiscriminately and on demand any amount of gold against its notes and deposits. It thereby renders no national service, nor "defends" nor "protects" its currency. It merely fulfills the contract it made when it issued the money substitute. (1985, p. 69)

Moreover, Sennholz claims, as do the free bankers, that banks have a natural limit to the issue of fiduciary media. "Redemption demands and the threat of drains of their gold reserves," he wrote, "would restrain the issuers of money substitutes from inflationary expansion" (Sennholz 1985, pp. 69-70).⁴ In contrast Mises thought that a free banking system could inflate fiduciary media without limit. "The quantity of fiduciary media in circulation," he wrote, "has no natural limits," being constrained only by a policy adopted to do so by the banking system. By issuing fiduciary media through the credit markets, a free banking system can lower interest rates and the purchasing power of money and hence, increase the demand for both credit and money. Consequently, Mises did not think that there was any limit to the issue of fiduciary media in a free banking system or that such a system automatically adjusted the issue of fiduciary media to changes in money demand. These results could only occur in a competitive, free banking system, one in which each bank is independent of the others, having a small and limited clientele and unable to coordinate its issue of fiduciary media with that of other banks. Although competitive, independent banks would have a limit to their issue of fiduciary media, Mises (1980, pp. 331-53) argued free banks could operate as a cartel and therefore, inflate their fiduciary media without limit.⁵

³On his view, see Mises (1980, pp. 65-66).

⁴The free bankers argue that banks expand their stock of fiduciary media to accommodate rising money demand, but will not issue fiduciary media beyond the amount demanded. See Selgin (1988, pp. 89-125) and White (1989, pp. 218-42). Hayek (1976, pp. 46-55) does not think it useful to distinguish between money and money substitutes; but, like the free bankers, he claims that competition to provide a currency of stable or predictably changing value would require banks to limit their issue of currencies.

⁵White himself argues that the natural development of a free banking system results in cartelizing arrangements that extend the clientele of each bank to all traders in the market and

Apparently, Mises (1980, pp. 346-47 and 491) became convinced that competitive banking conditions were theoretically unlikely or could not be reestablished in the post-Second World War American economy, because he offered a program of monetary reform, which he designed to prevent the possibility of monetary inflation, that would legally restrict any further issue of money substitutes to money certificates. Rothbard, in contrast, consistently argued that only money certificates are consistent with private property. Fiduciary media was, in his view, fraudulent and therefore, impermissible in the market economy (Rothbard 1994, pp. 33-45).

THE GOAL OF MONETARY REFORM

Although all of the Austrian authors surveyed agree that reform should restore the market monetary regime, their differences concerning who can produce money and the character of money substitutes on the market generate different end states for monetary reform to attain. In addition to these variations, the differing views held by the authors on the nature of private property affect their reform proposals. Hayek (1973) treats private property in an exclusively instrumental way. Its adoption by market societies permitted them to flourish sufficiently to out compete nonmarket societies in mankind's evolutionary development. But private property itself is solely a human device that serves this end. Mises also considers private property a means to a valuable end, namely, that of constructing, maintaining, and developing the division of labor, which, in turn, is necessary for the flourishing of mankind. Although he considers the legal code of private property as having instrumental value, Mises holds that private property itself is grounded in human nature, i.e., the human person engaged in human action. Moreover, in contrast to Hayek, he views private property rights and the market, not as a spontaneous development, but as the product of man's reason and, therefore, subject to "constructivist" improvement via rational investigation (Mises 1998, pp. 32-41, 199, 264-70, 650-53, 755-56; 1985, pp. 18-20, 33-34, 60-70).⁶ For Rothbard and Sennholz, private property is both a means and an end. It is part of natural law or moral law and therefore, a matter of justice. Private property not only restores the market economy and its economizing operation, but human rights as well. As Sennholz put it:

The history of Western society is a long register of the struggle between the individual longing to be free and the political lord insisting on sovereignty and order. The struggle over money must be seen as an integral part of this fateful confrontation. Where people seek liberty, self-determination and self-government, they seek to regain their freedom of money or, at least, to force government to be honest in monetary matters. (Sennholz 1985, p. 61)

For Rothbard and Sennholz, to restore the market means to defend private property from aggression. For both authors, private property is part of the natural order and the foundation of the market economy and defending it is part of justice or right. Rothbard (1999), however, links all private property to the human person himself, who has rights to his mind and body, the things he creates with his labor, and acquires from others by voluntary transfer and exchange. In contrast, Sennholz emphasizes production in the market as the source of property. He wrote:

hence, renders a system in which, Mises would claim, the issue of fiduciary media has no limit. See White (1989, pp. 225-38).

⁶For Hayek on "constructivism" see, Hayek 1973 (pp. 1-34).

Throughout the history of man, private property has resulted from acquisition of ownerless things, from violent expropriation of previous owners, or from production by human skill and energy. . . . [But] in an exchange economy . . . private ownership of the means of production is a fundamental institution. It springs from production and comes into existence peacefully. . . . [P]rivate ownership means full control over the uses and services of property, not merely a legal title while government is holding the power of control. . . . Private property is no special privilege enjoyed by the owner class. It is a natural institution that facilitates orderly production and division of labor. (Sennholz 1982, pp. 1-3)

Moreover, Rothbard grounds his ethical claims about private property in the natural law tradition of the late scholastics, Hugo Grotius, and John Locke, while Sennholz rests his claims on the scripture. Sennholz wrote:

The market order or capitalism finds its answers [to ethical questions] in the Judeo-Christian code of morality. Private ownership in production is squarely based on the ten commandments. It obviously rests on the eighth commandment: "Thou shalt not steal." . . . The private ownership system also builds on the solid foundation of the sixth commandment: "Thou shalt not kill," which includes every form of coercion and violence. . . . To freely exchange goods and services, the contract parties must not deceive each other. They "must not bear false witness," which is the ninth commandment of the Decalogue. (Sennholz 1990, pp. 1-2)

As part of the natural law tradition, Rothbard argues that private property stems from a person's natural ownership of himself and the things he acquires with his labor out of nature and then to things he produces by the application of his labor. By starting with the individual person, the things he acquires from nature, and that which he produces with his own labor, Rothbard is able to maintain the truth that there can be only one legitimate owner of something, even when he moves on to analyzing the division of labor economy in which goods are produced by groups of persons, none of which owns the output naturally from the application of his labor. Although more difficult to perceive, even in this case each thing is legitimately owned only by one person. The entrepreneur owns the output, the workers own their money wages, and so on. Keeping this point in mind, Rothbard renders a stricter defense of private property in the realm of money than that of the other authors. In particular, as mentioned above, Rothbard claims that fiduciary media is a fraudulent title of ownership to money as property because there can be only one legitimate title of ownership to each item of money and therefore, that only money certificates are consistent with private property.⁷ By stressing the right of contract, Sennholz and the free bankers gloss over the acquisition of property and ignore Rothbard's point about property titles. As mentioned above, Sennholz (and also Mises) claims that in a market economy banks have the right to issue money substitutes that are redeemable on demand at par, while the free bankers think that this right extends even to money substitutes which have "option clauses" stating that they are not always redeemable on demand at par. If anything, Hayek places even greater stress on the right of contract, for by it entrepreneurs carry on the competitive process and the competitive process, in turn, is the driving force behind social evolution. In the realm of money, Hayek (1976, p. 47), beginning from the right of contract, argues that banks not only have the right to issue fiat paper money, but any other financial instrument with

⁷On these points, see Hoppe, Hülsmann, and Block (1998, pp. 19-50).

“moneyness” or “near-moneyness” they might like to attempt to use in the competitive process.⁸

Initially, Mises did not argue for a pure private property order in money, along the lines of Rothbard, precisely because he considered private property a means to an end. Instead, he settled for a system that permitted state produced gold coins and privately issued fiduciary media. He, like Sennholz, thought that private property implied the legal right to issue money substitutes as long as they were perfectly redeemable on demand at par. But he came to realize that such a system could not attain his goal of a monetary regime that contained no money-side inflationary impetus. Given any foothold in monetary affairs, the state would always move step by step to an inflationary monetary regime, the exercise of which would eventually cripple, if not destroy, the market itself. Given the power to coin gold, the state would come to suppress the coinage of private mints by waiving its mintage fee. Once securely dominant as a money producer, it would make its coins legal tender, leading to the possibility of seigniorage from debasement. Likewise, if the state had the power to issue money substitutes, it would suppress the issue by private banks by waiving the printing or accounting fees. Once securely dominant as a money substitute producer, the state would rescind redemption to capture the revenue from inflating the stock of its, now, fiat paper money. Even if the state were reduced to merely having regulatory oversight of banks that could issue fiduciary media, it would eventually cartelize the banking system to permit coordinated monetary inflation.

As Mises came to realize, the goal of monetary reform must be the restoration of the monetary regime of the market economy in its purest form. No residual function of the state should be left as a beachhead from which it could launch another assault on the market monetary system. He wrote:

Sound money still means today what it meant in the nineteenth century: the gold standard. The eminence of the gold standard consists in the fact that it makes the determination of the monetary unit's purchasing power independent of the measures of governments. It wrests from the hands of the “economic tsars” their most redoubtable instrument. It makes it impossible for them to inflate. (Mises 1980, p. 480)

To achieve the goal of eliminating any possible source of monetary inflation, Mises was willing to curtail the legal right of private property he thought banks had to issue fiduciary media. Because he thought that the issue of fiduciary media in a coordinated banking system has no limitation and that such a system was either theoretically likely or historically entrenched in the American economy, he called for a special legal prohibition of any further issue of fiduciary media. Concerning monetary reform in America, he wrote:

The first step must be a radical and unconditional abandonment of any further inflation. The total amount of dollar bills . . . must not be increased by further issuance. No bank must be permitted to expand the total amount of its deposits subject to check or the balance of such deposits . . . otherwise than by receiving cash deposits in legal-tender bank notes. . . . This means a rigid 100 percent reserve for all future deposits; that is, all deposits not already in existence on the first day of the reform. (Mises 1980, p. 491)

⁸Hayek approvingly quotes these terms from Machlup.

Sennholz, in contrast to Mises and like Hayek, saw the goal of monetary reform as the elimination of the unjust monopoly privilege the state affords itself in the realm of money. He wrote:

The primary objective must always be the abolition of the money monopoly and legal-tender coercion. Man possessed, prior to the formation of any state, the right to provide for his own sustenance. He has an inalienable right to his life and to sustain it through his own effort and ability. Every restraint of this right, whether practiced by a monarch or a popular assembly, is a degree of tyranny. (Sennholz 1985, p. 77)

Sennholz, like Mises, thought that monetary reform must restrain monetary inflation, but by rejecting Mises's position that private property is primarily a means to an end and hence, his strategy of eliminating monetary inflation by creating a special legal prohibition, Sennholz was left to rely upon his view that the obligation of redemption would sufficiently restrain the issue of fiduciary media in a monetary system that prohibited monopoly privileges in money production and permitted banks to issue fiduciary media as a right of contract.

PROPOSALS FOR MONETARY REFORM

Rothbard proposes dissolving both the Federal Deposit Insurance Corporation and the Federal Reserve System, the latter by liquidating its assets to pay its liabilities and eliminating its regulatory functions. Treasury securities and other state issued paper assets owned by the Fed would be cancelled and its gold stock revalued to permit 100-percent redemption of all Federal Reserve Notes and Federal Reserve Deposits. The gold stock should be claimed by the note and deposit holders and redeemed for coins newly minted from the Fed gold stock by the Treasury Department. Banks would then have their reserves fully converted to gold and would maintain their own money substitutes without special privileges from the state. These provisions are an interim step to the establishment of 100-percent reserve banking, which Rothbard (1994, pp. 146-51) would presumably phase in by, for example, raising the required reserve ratio over time. To achieve 100-percent reserve banking in one fell swoop, Rothbard advocates defining the redemption rate of the dollar into gold so that all bank deposits, as well as Fed Notes and Deposits, could be redeemed into the Fed's gold stock. Whether immediately or eventually, the issue of fiduciary media would be legally prohibited (Rothbard 1992, pp. 12-14; 1983, pp. 254-69).

As Rothbard notes, the unresolved issue raised by his plan is whether it is better to undergo a deflation of the money stock from the immediate elimination of fiduciary media or to permit a sizeable wealth transfer to banks from backing all their money substitutes with gold reserves. The advantage of monetary deflation, and the concomitant credit contraction, is that it directly restores the economizing of the market in money and credit. Without a contraction of credit to reestablish 100-percent reserves, banks would never return, strictly, to financial intermediation of credit; but, instead would maintain a fixed amount of circulation credit. Leaving existing fiduciary media and circulation credit in place freezes the malinvestments from the prior credit expansion based on the issue of fiduciary media into the production structure and distorts the avenues of future saving and investing, even when they are based solely upon commodity credit and monetary certificates. Moreover, the liquidation and restructuring of the production structure that would be necessary to restore the operation of the market in Rothbard's reform is no different in kind from that of any bust following a boom. And since the banks would not be under the financial pressure that bears down upon them in a bust, they would have more leeway in managing liquidation. Even the magnitude of the restructuring could be lessened if banks

built their reserves to 100 percent by choosing to sell Treasury securities and shorter-term loans rather than longer-term loans. And even if the magnitude of the liquidation and restructuring process exceeded that of a typical bust, the negative consequences of the process depend more upon the existence of state intervention designed to prevent or retard it than on the magnitude of liquidation and restructuring needed to restore the production structure. Therefore, the pain of liquidation is a reason to call for the elimination of these state interventions more than it is to prevent liquidation itself. Also, the state has grown to such gigantic proportions that liquidation and reconstruction of the production structure would follow in the wake of any significant rollback of the state. Imagine the restructuring that would take place as a result of reforms that Austrian economists typically call for, say if the state's budget was cut 90 percent or even if the budget of a large state program, say that of defense, was cut 90 percent. No advocate of *laissez faire* accepts the pain of liquidation and restructuring as an argument against a significant rollback of the state in any other area except monetary reform because it would be tantamount to accepting the *status quo*.⁹ At most, such advocates call for a graduated reform program to soften the blow of the adjustment. Even Rothbard himself, who was no gradualist in matters of reform, is willing to entertain a gradualist plan. But his more radical proposal might still be superior to a gradualist one if all state impediments to liquidation and reconstruction are removed prior to monetary reform. If, however, his nondeflationary option is deemed superior on prudential grounds (because, for example, the requisite elimination of state intervention necessary to avoid a prolonged and painful liquidation and restructuring process under his immediate deflationary proposal is not politically possible or because the interim period in which banks gradually build their reserves to 100 percent under his gradualist deflationary proposal leaves a window of opportunity for the state to reassert its power over monetary affairs) then the wealth transfer to banks that Rothbard considers unjust could be compensated for by having the banks surrender all or part of their Treasury securities for the gold reserves they receive from the Fed. This asset swap would have the added advantage of permitting even more of the national debt to be cancelled when the Fed is liquidated.

Mises's reform program is less thoroughgoing than Rothbard's, but nonetheless attains the goal, at least temporarily, of permitting no further monetary inflation and credit expansion. This would be done by freezing the stock of Fed notes and prohibiting any further issue of fiduciary media. Simultaneously, the market in gold must be unfettered by any state intervention and a transition period allowed in which the gold market would be free to reach market-clearing conditions. Once the market-clearing price of gold has been established, Mises advocates the creation of a Conversion Agency by the state with the main function of redeeming dollars for the state's gold stock at the parity value. To restore the use of gold coin as a medium of exchange and thereby, forestall a replay of progressive state intervention into the monetary regime, Mises calls for middle-level denominations of Fed currency to be withdrawn from circulation so that gold coin itself would be held by people in their cash balances and used by them in transactions. The Conversion Agency could then issue new small and

⁹On the exception made for monetary reform, Sennholz writes,

No reasonable economist would want to revolutionize economic life through a radical monetary reform. He does not want to make gold the only money, forbidding government issue of any kind and suppressing bank notes and demand deposits used as media of exchange. Such a reform would require radical government intervention and greatly reduce the country's money supply. Prices and wages would have to be drastically cut, which no modern society could withstand in an orderly fashion. (1973, pp. 58-59)

large denomination notes when its gold stock increased or when old notes became too worn to remain in use (Mises 1980, pp. 490-95).

In addition to preventing future monetary inflation by prohibiting any further issue of fiduciary media, Mises sought to prevent monetary deflation by permitting existing fiduciary media to remain in use. As noted above, a nondeflationary program has the drawback of freezing malinvestments into the production structure and making future saving and investing less economizing than it would be with complete liquidation and restructuring. Moreover, Mises's reform leaves the state enough of a role in monetary affairs to reassert an inflationary monetary regime over time. Despite his calls to keep the Fed from intervening, as long as it exists its regulatory powers over banks remain a beachhead from which it could reassert its central-banking powers. Likewise, the Conversion Agency could extend its powers over time to include issuing unbacked notes to help fund the state "temporarily" in times of "crisis." As Mises (1998, pp. 851-57) himself argued, any level of state intervention tends to be unstable resulting either in an expansion or contraction over time. It is better, then, to eliminate intervention altogether.

The reform program of the free bankers accepts Fed notes as money proper, to eventually be held exclusively as bank reserves, and the freedom of banks to issue their own notes redeemable on demand (but with option clauses permitting temporary suspension of redemption) into Fed notes in addition to their checkable deposits, which would also be redeemable into Fed notes on demand. Once public demand for bank notes rose sufficiently, then the stock of Fed notes, the managed expansion of which would now no longer be needed to accommodate increases in money demand, could be permanently frozen and held exclusively by banks as reserves. Bank regulations covering reserve requirements, interstate banking, and bank diversification would be repealed. To help bank notes supplant Fed notes as a medium of exchange, which the free bankers agree would be problematic since they are currently the generally accepted medium of exchange, the Fed should saddle them with special disadvantages, including making replacement Fed notes oversized, printed in red ink, or issued in odd denominations. Once Fed notes nearly left circulation altogether, then their stock could be frozen and the Federal Reserve Board and Federal Open Market Committee would be dissolved. The Fed's clearing operations would be privatized by turning over the assets of the twelve district banks to their stockholders. The private clearinghouse would then centralize all Fed notes held as reserves which were not needed by banks to fulfill their redemption obligations. Like clearinghouse operations, the insurance of bank liabilities would be left to the market. The state should not interfere if something else arose to displace Fed notes as money proper, such as gold or silver or even foreign currency or privately issued fiat paper money (Selgin 1988, pp. 167-72).

Although it recognizes the difficulty of newly issued bank notes supplanting Fed notes as media of exchange, the free bankers' proposal has not faced the magnitude of this problem. It is not a simple matter of overcoming a long-standing preference for one well-established thing with another newly offered thing of equal serviceability; as in choosing turkey over chicken as a source of protein. It is, instead, a problem of making something that is not a medium of exchange into such a medium and one superior to the existing money. As Mises argues, to become a medium of exchange, an item must be redeemable on demand at par for money. Only a practice of such redemption by the issuer of the money substitute can build a clientele, including non-customers, among whom it serves as a medium of exchange. In a market economy, banks can issue any financial instrument made profitable by its customers' demand, even interest-bearing checkable deposits. But they cannot use the incentive of an interest payment to build a clientele for its use among noncustomers. If the incentive is given to the customer, it cannot simultaneously go to the noncustomer and *vice versa*.

If it goes to the customer, then the noncustomer receives no benefit sufficient to overcome the cost of accepting an option-clause money substitute. (If there is no option clause on fiduciary media, then the banks and their customers have committed fraud with their noncustomer clientele and if there are no fiduciary media then banks have no interest incentive to give.) The noncustomer would always have the alternative of insisting on money itself or money certificates, if other banks found that demand for their money certificates was great enough to cover the costs of producing them and hence, made them available. If the incentive goes to the noncustomer, then the customer has no incentive to demand fiduciary media money substitutes. It is difficult, therefore, to see how option-clause money substitutes could ever supplant money itself and money certificates in a market economy.

Moreover, as discussed above, if the free bankers reform could be made to work it would establish a cartelized banking system, not a market of competitive, independent banks. Therefore, it would permit unlimited monetary inflation and result in credit expansion and the boom-bust cycle. Having failed to eliminate the main economic problem of the existing system, it would be subject to repeated efforts at reform and, likely, reform in the direction of more state control. And even if it operated in the manner described by the free bankers, the role of the state in the system is even larger than in Mises's and hence, the state is even more likely to rollback reform and reassert its power over money and banking. Because the Fed retains the power to manage its own notes during the period of transition to bank notes, for example, it may do so in a manner to retain its power and await the opportunity to reassert itself. Even after the transition period when Fed Notes serve almost exclusively as bank reserves, the Fed is still in a position, albeit a weakened one, to reclaim its monetary authority. All that it would need is the opportunity provided by a financial crisis, which remains likely in the type of monetary system envisioned by the free bankers.

Hayek's reform program calls for the repeal of all legal tender laws and legal disabilities to privately produced money so as to eliminate the government monopoly on money production. Given this, he believes that each private bank would issue its own money, denominated in its own units, and manage its supply to render its value stable or predictable in its variations because stable or predictable value is what users of a medium of exchange would value most about it. When traders saw that certain bank monies were more stable or predictable in value than state money, they would begin to use them and eventually supplant state money if it, too, was not managed in a sound way. Once established, the competitive process among banks would lead to unpredictable, but beneficial, innovations in money. According to Hayek (1976, pp. 92-101), the main obstacle to his proposal is public opinion in favor of the state's money and that a "free money movement" is needed to overcome it in the same way that the nineteenth-century "free trade movement" convinced the public to reject mercantilism and accept free trade.

Hayek's proposal suffers more severely than that of the free bankers from rejecting the Menger-Mises dictum concerning the introduction of a new money. Given that Fed notes are money, a bank would find it virtually impossible to build a clientele for its own fiat paper notes, denominated in "ducats." Even those customers of a bank who were eager to acquire a money of stable value would face an enormous disability in accepting its fiat paper notes. Because these notes are not traded on the market and therefore, have no exchange value, i.e., there are no "ducat" prices for goods or exchange rates for other monies, no one could determine how much of them to accept or give in exchange for goods. And even if a few customers accepted the notes at some exchange rate for dollars that would do nothing to make them a medium of exchange. It would merely establish a dollar price for "ducats" in the same way that prices are established for all goods that trade for and against money. Within an established monetary market economy something can only become a medium of exchange by

first becoming a money substitute, i.e., by the issuer redeeming them for money on demand at par. But, then, such a money substitute could become fiat paper money only by a permanent rescinding of redemption, an act which violates private property rights. Moreover, by permitting the state to openly compete against private money producers, Hayek's reform establishes only the mixed economy, not the market economy. And although it is true that in the mixed economy the state's operation is subject, at least somewhat, to the market, it still distorts the economizing activity of the pure market economy. Having the power to coerce allows the state to circumvent the stricture of economic calculation to some degree. No private enterprise can cover losses or raise capital funding with tax revenues. And no advocates of *laissez faire* would claim that the market economy had been restored if the state was to operate facilities in various industries even if it did so without legal protection from private enterprise competition. Rescinding the privilege of first class mail delivery, for example, would not restore a free market in this service because the state operation could rely on tax-funded subsidies to out compete its private rivals. The market economy is not established unless all enterprise is private.

To settle for the mixed economy makes it easier for the state to reassert, or even maintain, its dominance in monetary affairs than it could under the proposals of either Mises or the free bankers, in which the state is left with only a subsidiary role in monetary affairs. Even if the success of competing monies depended only on the stability or predictability of their values, as Hayek contends, all the state need do to forestall competition, since it dominates the market already, is manage its money to produce this result. At an opportune moment in the future, it would then seize the initiative to pass legal tender laws and begin to inflate anew.

Sennholz's proposal is similar to Hayek's in that he seeks to eliminate the state's monopoly over money and establish the legal foundation of private money production. "We seek no reform law, no restoration law, no conversion or parity, no government cooperation: merely freedom," Sennholz wrote, "the road is short and direct, and yet, depending on the resistance offered by ignorance and prejudice, by political greed and lust for power, it may take us many years to traverse." Like Hayek, Sennholz believes that reform must be fought on all fronts by a "free money movement" that works "through information, education, legislation, litigation, and demonstration." The ultimate goal of such a movement is to repeal "all legal tender laws" and rescind "all monopoly banking privileges." In other words, establish the conditions under which private money could develop in open competition with government money. The result of reestablishing a free market in money, Sennholz argues, is that "good money would drive out bad money." The government would only be able to maintain its role as a money producer by emitting sound money, freely chosen by traders in the market. Given freedom in the realm of money, Sennholz (1985, pp. 77-83) is certain that people will select gold.

Although this proposal does not suffer from some of the difficulties demonstrated by Mises in those of the free bankers and Hayek, several problems with it remain. First, like Hayek's proposal, it does not restore the market economy, but only establishes the mixed economy. Therefore, the state could use its taxing and subsidizing power to give its monetary operations a competitive advantage. If the state were given the opportunity to compete against private mints in the production of gold and silver coins, nothing would prevent it from providing the minting service for free and covering its losses with tax revenues. It would, thereby, forestall private enterprise and retain its dominance over money. Then, at an opportune time in the future, the state could proceed, step by step, to reestablish its fiat-paper system. Although the system of state minting of coins would be preferable to the current fiat-paper regime, it would not achieve the fundamental goal of monetary reform, which is the permanent restoration of the market economy in the realm of money.

Second, the transition period from the current monetary regime to the restoration of a gold standard raises additional problems. The development of money in a free market conforms to two principles: the selection of the commodity most suited to performing the medium of exchange function (presumably still gold) and the elimination of multiple monies. Traders tend to adopt a single commodity as money because of the superior properties of gold as a medium of exchange, a tendency reinforced by the benefit of eliminating the direct exchange of monies when trading from one market, in which one commodity is money, to another market, in which a different commodity is money. The Sennholz proposal permits, although it does not require, the retrogression of this tendency with different entrepreneurs trying out different commodities as money. But gold's superiority can be objectively established. Hence, the eventual adoption of gold as money is nearly certain, making the period of transition to reestablish gold as money unnecessary. It would be more efficacious in reaching this goal to directly restore the gold standard by redemption of the dollar into gold and then permitting private enterprise to compete within the monetary standard that would arise eventually anyway. This modification would maintain the benefits of a uniform money while allowing traders to choose any commodity they prefer as money. But their selection would be constrained to include only those commodities superior to gold in the properties of a medium of exchange and therefore, with a reasonable possibility of supplanting gold as money.

Moreover, the current dominance of the dollar as money implies another difficulty for private enterprise during the transition period. Even if entrepreneurs, under the Sennholz proposal, all adopt gold instead of trying out other commodities as well, their money will face a difficult task in competing with the dollar. The transition period in which gold slowly displaces the dollar may be extended by a policy of the state to increasing the purchasing power of the dollar, by ceasing monetary inflation, or by a policy of increasing the exchange ratio between the dollar and gold, by selling gold. In any case, this transition is unnecessary. By making the dollar redeemable into gold, gold becomes money immediately.

Finally, Sennholz's proposal does not eliminate the problem of monetary deflation during the transition. As noted above, he was highly critical of proposals that required such deflation, but his own reform suffers from the same malady, albeit not of the severity of that required by Rothbard's proposal. To restore freedom in banking, the Fed's regulatory powers would have to be eliminated even if its money production activity remained intact. Under the Fed's coordination, however, bank reserves have been lowered to historically unprecedented levels. A restoration of free, competitive, independent banking would certainly involve the buildup of bank reserves from the current level of 10 percent. Even in the semi-cartelized banking system of the nineteenth century, banks tended to keep reserves between 25-40 percent of their money substitutes. But an accumulation of reserves requires the same deflationary process as would occur under Rothbard's proposal. Banks would have to reduce their issue of fiduciary media and circulation credit by liquidating loans to buildup their reserves and therefore, set in motion a restructuring of the production structure.

CONCLUSION

For the Austrian economists surveyed above, the goal of monetary reform is to permanently restore the market economy in money. It is to return to the highest stage of development of money on the market as explained by Menger and Mises. Monetary reform, therefore, should leave no role for the state and the slightest possibility of the state reasserting its power over monetary affairs. Among the proposals surveyed, the one offered by Rothbard most fully attains this end. Gold should be made money in

one bold stroke by making the dollar redeemable for gold at a fixed rate. Fed currency would then become a money substitute along with the other forms of money substitutes such as checkable deposits. The rate of redemption should be set either to establish one hundred percent reserves of gold against Fed notes and Fed deposits or all money substitutes. If the latter, then banks should swap Treasury securities for gold reserves used to back their fiduciary media. If the former, then all state interventions that would hamper liquidation and restructuring of the production structure should be repealed. Deciding between the two would be a prudential matter. The important point is to eliminate the Fed altogether and prevent, by law, the state from establishing its own monetary operations in competition with private enterprise or from regulating financial institutions in any respect.

As part of the liquidation of the Fed, a bank consortium or a private group of capitalist-entrepreneurs could purchase the check clearing and auditing apparatuses of the Fed to make these activities private. If this proved unprofitable, private enterprises would emerge to provide these services as long as banks found it valuable enough to pay fees high enough to cover the costs of providing check clearing and bank clientele found it valuable enough to pay fees high enough to cover the costs of auditing.

Private mints would produce coins according to profit and loss, which would be determined by the demand for money. Banks would be legally free to issue money certificates as titles of ownership to money proper and other nonmonetary financial instruments. All such issues would be regulated by profit and loss as determined by demands for them. Any issue of fiduciary media should be made illegal.

No matter what reform proposal is adopted, however, the state will attempt to strike back against it to restore to itself the immense benefits it receives from the existing system. A reform's long-run success, then, depends on making it as difficult as possible for the state to reassert its power. No matter how successful establishing the mixed economy, as Hayek or Sennholz propose, or a halfway house, as Mises or the free bankers propose, may prove to be in the short run, neither such reform is as likely to endure as Rothbard's.

Whatever proposal for the restoration of a market monetary regime is in the end adopted, however, all proponents of this goal can accent to the sentiments express by Sennholz:

In freedom, the money and banking industry can create sound and honest currencies, just as other free industries can provide efficient and reliable products. Freedom of money and freedom of banking, these are the principles that must guide our steps. (1985, p. 83)

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