

THE FREE MARKET

THE MONTHLY PUBLICATION OF THE MISES INSTITUTE

The Myth of the Unchanging Value of Gold

JOSEPH T. SALERNO



According to mainstream economics textbooks, one of the primary functions of money is to *measure* the value of goods and services exchanged on the market. A typical statement of this view is given

by Frederic Mishkin in his textbook on money and banking. “[M]oney . . . is used to measure value in the economy,” he claims. “We measure the value of goods and services in terms of money, just as we measure weight in terms of pounds and distance in terms of miles.”

When money is conceived as a measure of value, the policy implication is that one of the primary objectives of the central bank should be to maintain a stable price level. This supposedly will remove inflationary noise from the economy and ensure that any changes in money prices

that do occur tend to reflect a change in the relative values of goods and services to consumers. Thus, for mainstream economists, stabilizing a price index based on a basket of arbitrarily selected and weighted consumer goods, e.g., the CPI, the core CPI, the Personal Consumption Expenditure (CPE), etc., is a prerequisite for rendering money a more or less fixed yardstick for measuring value.

This idea—that a series of acts involving interpersonal exchange of certain sums of money for quantities of various goods by diverse agents over a



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Editor:
Ryan McMaken

Managing Editor:
Judith F. Thommesen

Contributing Editors:
Thomas J. DiLorenzo
Jeffrey M. Herbener
Robert Higgs
Mark Thornton

Publisher:
Jeff Deist

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Mises Institute
518 West Magnolia Avenue
Auburn, Ala. 36832-4501
Phone: 334.321.2100
Fax: 334.321.2119
Email: contact@mises.org
Web: mises.org

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given period of time somehow yields a measure of value—is another ancient fallacy that can be traced back to John Law. Law repeatedly referred to money as “the measure by which goods are valued.” This fallacy has been refuted elsewhere and rests on the assumption that the act of measurement involves the comparison of one thing to another thing that has an objective existence, and whose relevant physical dimensions and causal relationships with other physical phenomena are absolutely fixed and invariant to the passage of time, like a yardstick or a column of mercury.

In fact, the value an individual attaches to a given sum of money or to any kind of good is based on a subjective judgment and is without physical dimensions. As such the value of money varies from moment to moment and between different individuals. The price paid for a good in a concrete act of exchange does not measure the good’s value; rather it expresses the fact that the buyer and the seller value the money and the price paid in inverse order. For this reason neither money nor any other good can ever serve as a measure of value.

Unfortunately, advocates of a gold-price target wholeheartedly embrace this mainstream doctrine while giving it an odd twist. They begin with the wholly unsupported assumption that one commodity, gold, is stable in value and that, therefore it can serve as the lone guiding star—or “The Monetary Polaris” as Nathan Lewis terms it—for Fed monetary policy. According to Steve Forbes, writing in the introduction to Lewis’s *Gold: The Monetary Polaris*, real gold standards have one thing in common: “They use gold as a measuring rod to keep the value of money stable. Why? Because the yellow metal keeps its intrinsic value better than anything on the planet.”

Louis Woodhill, in a *Forbes* column, writes in a similar vein, explaining that “[t]he fundamental validity of the gold standard rests upon the premise that the real value of gold remains constant over time. . . . The most fundamental thing about a unit of measure is that it be constant. . . . Gold is not money, and it should not be money. However we can and should use gold to define the value of the dollar.”

These passages reflect an almost mystical belief that the “intrinsic” or “real” value of gold is, for all practical purposes, eternally unchanging, unaffected by the continual flux of human valuations, stocks of resources (including gold itself), technology, and entrepreneurial judgments that define the essence of the dynamic market economy. Furthermore no definition is ever given of what exactly the concept of “intrinsic value” means or in what units it is expressed.

Historical experience clearly shows that the value of gold *vis-à-vis* other commodities has fluctuated over the centuries, even when gold has served as the monetary standard. This was certainly the case, for example, when the US returned to the gold standard after the Civil War. From 1880 to 1896, US wholesale prices fell by about 30 percent. From 1897 to 1914 wholesale prices rose by about 2.5 percent per year or by nearly 50 percent. This rise came about mainly as the result of a nearly doubling of the global stock of gold between 1890 and 1914 due to discoveries of new gold deposits in Alaska, Colorado, and South Africa, and improvements in the technology of mining and refining gold.

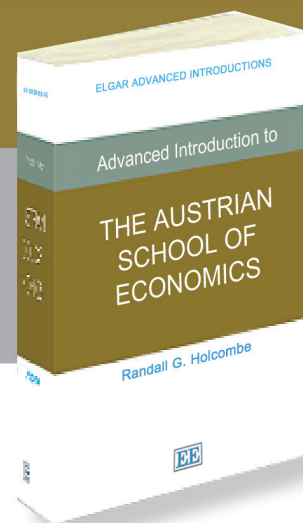
Proponents of gold-price targeting thus seem to ignore both theory and history in assuming that once the dollar price of gold has been fixed, the value of money itself becomes forever stable and immune to the influence of market forces of supply and demand. Inflation and deflation are, therefore, *ipso facto* banished from the economy. This implies that

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A New Austrian Textbook for All Economists

An Interview with Randall G. Holcombe

Randall G. Holcombe is an Associated Scholar at the Mises Institute, DeVoe Moore Professor of Economics at Florida State University, and past president of the Society for the Development of Austrian Economics. He recently spoke with the Mises Institute about his new textbook Advanced Introduction to the Austrian School of Economics, now available from Edward Elgar Publishing.



Mises Institute: Why did you decide to write this book?

Randall Holcombe: I received an inquiry from Edward Elgar, the publisher, asking me if I'd be interested in writing it, and I agreed. They wanted a short book of about 50,000 words that would introduce people to the ideas of the Austrian School, and that's what I wrote. The text runs just 116 pages, which doesn't count the preface, index, and an extensive list of references at the end.

Writing the book was the publisher's idea, and I thought about it for a while before I agreed. One reason I hesitated is that, if you talk with a group of Austrian economists, they all have different ideas about the core ideas of the School. I didn't want to write a book saying, "here are the most important ideas of the Austrian School," and then start a debate about what I might have left out, or included that didn't really belong. Ultimately, I decided that the benefits of writing the book would outweigh those risks, so I took on the project.

MI: Who is the target audience?

RH: Economics students, including undergraduates, are groups I am targeting with the book. The book is not an introductory economics text from an Austrian perspective, and assumes that the reader already knows some economics. But even a student who has only taken an introductory economics course will have enough background to understand what is in the book. The idea was to write a book for people who already know some economics, but are not familiar with the Austrian School. There are lots of people with some background in economics who have heard of the Austrian School, but don't have a good idea about what distinguishes the Austrian School from mainstream economics, or from other

schools of thought. So the idea was to write a book that emphasizes the ideas that separate the Austrian School from other approaches to economics.

MI: Have you noticed any increase in interest in Austrian economics among the students you see?

RH: Yes, absolutely. We don't have a course in Austrian economics at Florida State, so I don't teach Austrian theory directly. But we have an active student libertarian club that is interested in Austrian economics, and word gets around that I take an Austrian approach to my teaching. I often have students come up to me after class asking me about books and articles written by Austrian School economists. They find them on their own, without my referring to them in class. One of the most common places they find these ideas is on the Mises Institute website, so I have to give the Institute a lot of credit for making so much Austrian scholarship readily available.

MI: Why do you think there is more interest now?

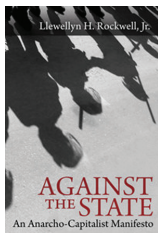
RH: There are several reasons. One is that academic economists are increasingly looking for alternatives to mainstream ideas. Economists were probably most unified on the mainstream paradigm back in the 1970s when the neoclassical framework defined microeconomics and Keynesianism defined macroeconomics. Since then, there has been more diversity in the way that academic economists

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Mises Scholar and Alumni Notes



LEW



CHAIRMAN LEW ROCKWELL's new book *Against the State: An Anarcho-Capitalist Manifesto* was published in May and is now available in the Mises Store.



JEFF DEIST

PRESIDENT JEFF DEIST

appeared on *The Tom Woods Show* to discuss his time in Washington, D.C. as Ron Paul's chief of staff. A transcript of the interview "Ron Paul on Capitol Hill" can be found in *Mises Daily* at mises.org.



JOSEPH SALERNO

SENIOR FELLOW JOSEPH SALERNO was featured on the *Butler on Business* radio show where he discussed the failures of central planning. "An Interview with Joseph Salerno" can now be found on mises.org under the Audio/Video tab.



GEORGE REISMAN

ASSOCIATED SCHOLAR GEORGE REISMAN

in May was featured on *Power Trading Radio* where he discussed economic inequality, and on *The Exceptional Conservative Show* to discuss his new book *Warren Buffett, Class Warfare, and the Exploitation Theory*.



ROGER GARRISON

ASSOCIATED SCHOLAR ROGER GARRISON

edited the new book *Elgar Companion to Hayekian Economics*, a collection of essays providing "an in-depth treatment of F.A. Hayek's economic thought from his technical economics of the 1920s and 1930s to his broader views of the spontaneous order of a free society." The book will be available in late 2014.



SHAWN RITENOUR

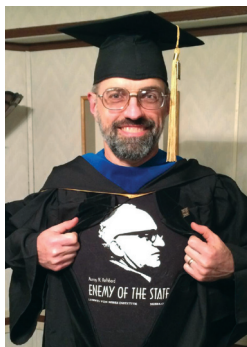
ASSOCIATED SCHOLAR SHAWN RITENOUR

in June delivered his talk "Economic Freedom and the Early American Republic," at the American Founders Luncheon Series in Pittsburgh.



PER BYLUND

ASSOCIATED SCHOLAR PER BYLUND's chapter "Toward a Framework for Behavioral Strategy: What We Can Learn from Austrian Economics" was published in *Behavioral Strategy: Emerging Perspectives*, edited by T.K. Das. Bylund's article "Ronald Coase's 'Nature of the Firm' and the Argument for Economic Planning" will be published in the *Journal of the History of Economic Thought's* September issue.



KEN ZAHRINGER

KEN ZAHRINGER, an Austrian economist who studied under Peter Klein at the University of Missouri, received his Ph.D. in applied economics in May.

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A NEW AUSTRIAN TEXTBOOK CONTINUED FROM PAGE 3

have viewed the discipline. The new institutional economics has been developed, experimental and behavioral economics has challenged neoclassical utility theory, and that has opened the door to looking at the ideas of the Austrian School too.

The collapse of the centrally-planned economies in the Eastern bloc also helped the Austrian School. The Austrian idea that rational economic planning cannot take place without markets and market prices was dismissed as wrong by many prominent economists up through the late 1980s, but it is now generally accepted. The socialist calculation debate, which worked against the Austrian School up through the 1980s is now working in the school's favor.

Also, the Austrian business cycle theory, which emphasizes malinvestment as a fundamental cause, is increasingly seen as a credible alternative in macroeconomics. The dot-com boom and bust, followed by the similar housing market boom and bust, make it apparent that mainstream macro models, which almost always treat capital as homogeneous, are inadequate for explaining macroeconomic phenomena over the past two decades. The Austrian approach to macroeconomics, which is built on a foundation of heterogeneous capital, lends much more insight.

All the reasons I've just given are reasons to take the ideas of the Austrian School seriously, but one of the big reasons they have been taken more seriously is that the internet has made those ideas more accessible. As I noted before, my students are discovering the ideas of the Austrian School on the Mises Institute website and other places on the internet, and that just would not have been possible twenty years ago.

MI: What insight of Austrian economics would you say is the most valuable to someone who is interested in economics but does not necessarily think of himself or herself as "an Austrian"?

RH: The two broad areas I would cite are entrepreneurship and macroeconomics. Mainstream economics is built on a foundation of equilibrium. The mainstream competitive model depicts competitive firms after all the competition has already taken place, so the role of entrepreneurship is left out. Profit is depicted as a sign of inefficiency, either because it is a sign of monopoly or a sign that markets are not in equilibrium. In fact, profit is necessary for efficiency, because profit is both the lure that encourages entrepreneurship and the sign that entrepreneurship has been successful at creating value. I place heavy emphasis on this idea in my book.

With regard to macroeconomics, the whole sub-discipline has been focused on how government policy can stabilize the economy. That's been true for a century. But because of its aggregate nature, the destabilizing effects that interventions have because they distort relative prices have been left out of mainstream macroeconomics. The Austrian approach to macroeconomics looks at the effect of government policy on relative prices—with the interest rate being the most important price, but not the only one—to show how government policy often is destabilizing. As I noted earlier, the Austrian approach to macroeconomics lends much more insight into the macroeconomic issues of the past two decades.

MI: If someone asked you to summarize what makes Austrian economics different in one or two sentences, how would you do it?

RH: That's a tough question, because that's what I tried to do in my book, and it runs more than one hundred pages! The insights about entrepreneurship, the market process, and the distinctive Austrian approach to macroeconomics would have to factor in. Actually, the fact that it is difficult to summarize in a sentence or two is what makes the Austrian School different and is something that keeps Austrian ideas from filtering into the mainstream more than they do. One big motivation for my writing the book was to answer just that question, and explain how Austrian economics is different from mainstream economics that students see in their introductory classes.

MI: As a tenured faculty member in economics, have you found that your use of Austrian economics has helped you as an economist, or is it a liability?

RH: This hasn't been an issue in my department. Nobody is critical of me because I am an Austrian economist. But then, I don't advertise myself as an Austrian economist,

and I have been fairly successful publishing in academic journals, which is a big component on how I am evaluated by my colleagues. I do what I think is good economics, using the best ideas that are available to me. The Austrian School has lots to offer, not because they are Austrian ideas but because they are good ideas. ■





Welcome to Mises Weekends, a new interview series featuring current events and current thinkers from an Austro-libertarian perspective. Join host Jeff Deist and his guests—scholars, economists, journalists, entrepreneurs and interesting thinkers—for new episodes every Friday.

YouTube users can subscribe at youtube.com/misesmedia.

Episodes are also available at **iTunes**, **Stitcher**, and at the **Audio/Video section of mises.org**.

Check the Mises Economics Blog and our social media outlets every Friday for the latest episode.



Mr. Thornton Goes to England

In June, Senior Fellow Mark Thornton spoke on the drug war as part of the Formal Thursday Debates series at Oxford University. Dr. Thornton writes:

The Oxford Union is one of the oldest and most prestigious debating societies and is strongly committed to the principle of free speech. Past debate presenters include the Dali Lama, Mother Teresa, Albert Einstein, former US presidents, UK prime ministers, and other leading politicians and diplomats, as well as leaders from the field of art and entertainment.



Oxford Debate Team

were opposed by Joseph Miles from Wadham College, Kathy Gyngell of the Centre for Policy Studies, Neil McKeganey, the Director of the Centre for Drugs Misuse Research, and Sarah Graham who is on the U.K. Advisory Council of the Misuse of Drugs.

While in London, Dr. Thornton visited the Adam Smith Institute where he met up with Mises University grads Ben Powell (now at Texas Tech University), David Skarbek (now at King's College), and Sam Bowman (now at the Adam Smith Institute). The group gathered to attend Prof. Powell's guest lecture "Sweatshops: Improving Lives and Economic Growth."

At the Oxford Union, debates are carried out in teams. My team consisted (*from left to right*) of a Liberal Democrat Member of Parliament from Cambridge, Julian Huppert, myself, David Browne, the student member from Merton College, and Richard Cowan, the former Director of the National Organization for the Reform of Marijuana Laws (NORML). We



Sam Bowman with Mark Thornton

IN MEMORIAM

Both the Mises Institute and the cause of liberty mourn the passing of a good friend. His support for our mission and concern for the future of freedom will always inspire us.

Mises Institute Charter Member **John “Jack” M. McLaren** passed away on August 4, 2013. Mr. McLaren, a resident of Texas, earned a Bachelor’s Degree in Civil Engineering and a Master’s Degree in Architecture from the University of Houston.

COMING EVENTS

Register online at mises.org or by phone at 800.636.4737.

July 20–26, 2014	MISES UNIVERSITY • Mises Institute
November 8, 2014	WEST COAST REGIONAL MISES CIRCLE IN COSTA MESA, CALIFORNIA
January 24, 2015	SOUTHWEST REGIONAL MISES CIRCLE IN HOUSTON, TEXAS
March 12–14, 2015	AUSTRIAN ECONOMICS RESEARCH CONFERENCE • Mises Institute

THE MYTH OF THE UNCHANGING VALUE OF GOLD CONTINUED FROM PAGE 2

any changes occurring in the quantity of money under a fixed-gold price regime are to be construed as benign and stabilizing adjustments of the supply of money to changes in the demand for money. Steve Forbes writes: “The fact that a foot has 12 inches doesn’t restrict the number of square feet you have in a house. The fact that a pound has 16 ounces doesn’t restrict your weight, alas—it’s a simple measurement. . . . The virtue of a properly constructed gold standard is that it’s both stable and flexible—stable in value and flexible in meeting the marketplace’s natural need for money. If an economy is growing rapidly such a gold-based system would allow for rapid expansion of the money supply.”

In other words Forbes’s “stable and flexible” gold standard would facilitate and camouflage an inflationary expansion of the money supply that would, according to Austrians, distort capital markets and lead to asset bubbles. The motto of our current gold-price fixers seems to be: “We want sound money—and plenty of it.” ■



Joseph T. Salerno, Academic Vice President of the Mises Institute, is a professor at Pace University, the editor of the *Quarterly Journal of Austrian Economics* and author of *Money: Sound and Unsound*.



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