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Book Review

The Gold Standard: Retrospect and Prospect

Peter C. Earle and William J. Luther, eds.
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The fifty-year anniversary of Nixon's decision to end the Bretton Woods system has renewed interest in the feasibility of the gold standard and whether it resulted in greater macroeconomic stability compared to the fiat dollar system. This is the subject of *The Gold Standard*, a collection of essays edited by Peter C. Earle and William J. Luther. Aside from the essays by Lawrence H. White and George Selgin, the papers are previously unpublished and are the result of a manuscript workshop hosted by the American Institute for Economic Research. Topics include historical analyses of the gold standard (Selgin, Thomas L. Hogan), the mechanics of the gold standard (Earle and Luther, Kwabena Boateng and Joshua Hendrickson), the feasibility of returning to the gold standard

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(Bryan P. Cutsinger), and "digital gold" in the form of cryptocurrencies (Luther). Research in gold and free-market money are venerable traditions in Austrian economics, and scholars working in these fields will find this book useful.

There are two important points about *The Gold Standard* that readers of the *Quarterly Journal* should understand. First, though it is not explicitly stated, all the authors adhere to Monetary Disequilibrium theory. The authors argue that the gold standard is an effective monetary system to the extent that it stabilizes nominal spending and results in the long run stability of the purchasing power of money. This is because changes in nominal spending require costly and unnecessary price adjustments. According to these Monetary Disequilibrium theorists, money is nonneutral in the short run but neutral in the long run. To quote Luther, if there is an increase in the demand for money, after the adjustment process has worked itself out "the initial vector of prices conveys relative scarcity just as well as the subsequent vector of prices" (p. 246). In other words, changes in nominal spending do not change long run relative prices or production.

Second, when discussing macroeconomic fluctuations, the essays in *The Gold Standard* do not mention Austrian business cycle theory. Instead, the authors, such as Alexander Salter, argue that "an unsustainable boom" results from price expectations becoming unanchored, which "fools businesses into overproducing and workers into supplying more labor than they otherwise would" (pp. 190, 192). Recessions are due to contractions in nominal spending that cause production declines in the face of sticky prices and price signal errors. In the book there is no analysis of whether the gold standard was (or would be) better than a fiat system at containing business cycles caused by artificially low interest rates.

This is not the place to discuss the merits of Monetary Disequilibrium theory or Austrian business cycle theory. I mention these two points to let the reader know what perspective *The Gold Standard* is coming from and what the book is (and is not) about.

I shall now comment on the following papers: Hogan's "How Good Was the Gold Standard?", "Monetary Rules: Is a Constrained Central Bank as Good as Gold?" by Salter, and Luther's "Digital Gold: The Case for Cryptocurrencies."

Out of the newly published papers in *The Gold Standard* I believe that Hogan's is the best. He quantitatively compares the nineteenth-century gold standard with the Federal Reserve era along output, price, unemployment and other macroeconomic metrics. He continues to build upon his own previously published papers on the subject as well as the seminal paper "Has the Fed been a Failure? (Hogan 2015; Selgin, Lastrapes, White 2012). Hogan's paper does an excellent job at showing that the Federal Reserve has not improved macroeconomic stability. My main criticism is that I wanted Hogan to directly respond to Jeffrey Miron's criticism that White, Selgin, and Lastrapes fail to compare the annual growth rate of real GDP per capita between the pre-and-post-Fed periods (Miron 2012). Though Hogan is familiar with Miron's paper and cites it in his current essay, he, like White, Selgin, and Lastrapes, uses only real GDP. Would Hogan's results be different if he used real GDP per capita? If so, is this an important criticism by Miron, or is real GDP per capita an inaccurate benchmark because population and demographic changes differed between the eras due to factors outside of monetary policy? Unfortunately, though Hogan addressed this issue in other work, he does not in the current paper, which gives the impression that it is a serious omission.

Salter's paper investigates whether a central bank constrained by a monetary rule could be considered an improvement over the gold standard. "It seems clear," Salter concludes, "that a well-designed monetary rule would enable a fiat money regime to outperform the gold standard, provided that the central bank was sufficiently committed to the rule." But "how to achieve and maintain that kind of commitment, however, is far from obvious" (p. 206). Salter's main criticism of the gold standard is that "its automatically-adjusting supply mechanism is somewhat sluggish," i.e., an increase in the "demand to hold gold coins" will decrease nominal spending and cause a recession before the elevated profitability of mining gold increases the money supply (p. 183). Setting aside the important question of whether a decrease in nominal spending would lead to a recession, Salter's analysis appears to omit the argument—traditionally held by supporters of Monetary Disequilibrium theory—that under a system of fractional-reserve free banking on a gold standard individuals will usually increase their demand for fiduciary media instead of gold coins, and banks will adjust the supply of fiduciary media to stabilize nominal spending. Can a central bank constrained by a rule theoretically outperform this system? Readers will have to look elsewhere for an answer to this question.

Luther's paper analyzes if cryptocurrencies, particularly bitcoin, can supplant traditional fiat standards. He notes that bitcoin and cryptocurrencies have skyrocketed in value because people forecast that they will be able to use them as money in the future. However, Luther argues that they will not because of network effects, government opposition, suboptimal supply constraints, and limited transactions capacity. I found his discussion of government opposition very informative: if governments sufficiently crack down on individuals and businesses using bitcoin as money, there is little chance that bitcoin will surpass central bank money. Of course, governments have every reason to do so because the greater use of cryptocurrencies will reduce the demand to hold fiat currencies and decrease tax revenue. While there undeniably will be bitcoin users who will successfully evade the law, Luther astutely notes that "most people prefer to be on the right side of the law most of the time" (p. 241). However, whether governments will impose draconian rules and crack down on cryptocurrencies enough to reduce their use as a medium of exchange remains to be seen.

In conclusion, *The Gold Standard* provides an honest assessment of the gold standard. It does not demonize gold. Instead it tries to weigh its strengths and weaknesses. Researchers will find a wealth of sources and material in this book. *The Gold Standard* is an important book readers of the *Quarterly Journal of Austrian Economics* should take account of, regardless of whether one agrees with every aspect of it.

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