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Book Review

Money and the Rule of Law: Generality and Predictability in Monetary Institutions

Peter J. Boettke, Alexander W. Salter, and Daniel J. Smith
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Peter C. Earle*

Over the course of eleven decades, the Federal Reserve has become the very picture of bureaucratic mission creep. Beginning with a relatively straightforward mandate in 1913 to prevent bank runs and financial panics, in 1946 the Employment Act added the requirement that "maximum employment, production and purchasing power" be a focus of monetary policy. In 1978, those requirements were amended to specify the maintenance of stable prices, maximum employment, and moderate long-term interest rates. (Because the latter has been infrequently mentioned, this is frequently referred to as a "dual mandate.") More recently, the argument has been made that in the wake of the 2007–08 financial crisis macroeconomic

* Peter C. Earle (pete.earle@aier.org) is Research Faculty member at the American Institute for Economic Research in Great Barrington, Mass., and a Ph.D. candidate in economics at the University of Angers in Angers, France.

stability has become a third (or fourth) addendum to the original mandate. And in the last few years, the suggestion has been made that monetary policy should also be crafted with a view toward both climate change and economic inequality.

In the opening stages of the COVID-19 pandemic, the Fed pumped trillions of dollars into the economy, dropped interest rates to near zero percent, and reopened several lending facilities introduced during the previous crisis. It also introduced a raft of entirely new programs, including the Primary Market Corporate Credit Facility (PMCCF), through which it would purchase bond issuances directly from corporate issuers; the Secondary Market Corporate Credit Facility (SMCCF), for purchasing corporate bonds and exchange-traded bond funds already trading in securities markets; and the Main Street Lending Program (MSLP), which provided loans to firms too large to participate in the Small Business Administration's Paycheck Protection Program (PPP). Several months later in July 2020, the Main Street Lending Program was expanded to include non-profit institutions.

The cost of that enormous, unprecedented monetary policy initiative is now apparent. Americans are seeing the highest levels of inflation since 1991, prices of various financial assets have skyrocketed, and between expansionary monetary policy measures, several rounds of fiscal stimuli, and nonpharmaceutical interventions (lockdowns, stay-at-home orders, etc.) economic distortions and disruptions are cropping up everywhere.

Thus *Money and the Rule of Law: Generality and Predictability in Monetary Institutions* (Cambridge University Press, 2021) from Professors Peter J. Boettke of George Mason University, Alexander W. Salter of Texas Tech University, and Daniel J. Smith of Middle Tennessee State University arrives at a propitious time. While to the public the Fed is largely perceived as an "apolitical and prudent steward of the macroeconomy with a wide range of duties… [t]he Fed always has been and always will be a creature of politics." (Salter 2020) To be sure, there is no shortage of accounts of US presidents prevailing over Fed officials to deliver accommodative policy measures.

The authors argue that the rule of law should be brought to bear on the actions of the Fed to eliminate the "systematic inefficacy of discretionary central banking." (p. 5) "[T]he Fed's century-long experiment with discretionary central banking is at best inconclusive, and at worst a failure," thus requiring constraint by an overarching legal structure. (p. 147) And that framework must conform to two general features: it must be unalterable by the Fed itself, and it must be "simple enough to admit minimal interpretive latitude." (p. 147)

The book is divided into two major sections. The first four chapters examine problems arising from discretionary monetary policy regimes; the subsequent three propose potential solutions.

After a foreword and introduction, Chapter 2 details the knowledge problems that face policymakers wielding discretionary powers. There are technical problems, such as the inability to directly observe or measure key metrics of macroeconomic performance. Worse, there are insurmountable knowledge problems of the type facing all central planners. In the same way that broader economic planning fails in their absence, "monetary policy makers lack a feedback mechanism that generates the requisite knowledge to maintain, or even tend toward, monetary equilibrium." (p. 37)

The third chapter analyzes the incentive set faced by monetary authorities. They are vulnerable to influences which may be endogenous, such as groupthink, or exogenous—from political figures or special interests. (In this section the authors note that most of the incentives facing central bankers are of a nonmarket nature. Undoubtedly true. Yet in light of recent revelations that senior Fed officials have engaged in personal securities transactions to gain financially from their own policies, it appears that market incentives now factor in as well.)

Crises are the focus of the fourth chapter. Unanticipated financial market disturbances are frequently the rationale undergirding unalloyed policy discretion for Fed officials. Yet Boettke, Salter, and Smith argue that it is in exactly those circumstances, when volatility and uncertainty are at their greatest, that rules of conduct should impose the most stringent limitations. Otherwise, emergencies permit the introduction and use of "fundamentally different paradigms and policymaking tools" which frequently produce negative and unintended consequences. (p. 96)

Chapter 5 traces the thought evolution of three giants of twentieth century classical liberal thought with respect to bringing rules to monetary policymaking. Friedrich von Hayek, Milton Friedman, and James M. Buchanan studied the political prerogatives of money and its misuse, and each came to different conclusions. Yet all ultimately agreed that some manifestation of the rule of law should be brought to bear on central bankers.

The sixth chapter begins by laying out the case for lawful money as an extension of the principles of lawful institutions within free societies more generally. Effective laws—those which foster cooperation, reduce uncertainty, and work reasonably well even in suboptimal conditions—tend to exhibit three characteristics: they are general, predictable, and robust. And any monetary constitution must, the authors specify, embody actual rules rather than "pseudo-monetary rules" (Selgin 2016) or inspiring "rule-like behavior." (p. 159)

The conclusion, "Money and Liberalism in the Twenty-First Century" (Chapter 7), investigates the means by which monetary institutions may be made subject to the rule of law yet retain the moral imperatives of economic growth, maximization of individual opportunity, and maintaining stable money prices (fostering the efficient allocation of resources, minimizing economic miscoordination, and so on).

No specific recommendations are ultimately made beyond that of a constitutional measure of some form: one "by which society's monetary institutions are subject to the reasoned deliberation of coequal citizens... embrac[ing] neither elitist technocracy or majoritarian passions." (p. 168) In closing, the authors express the hope that both an intellectual debate and public discourse over the form and implementation of such rulemaking begin sooner rather than later.

Although a trim 193 pages, the book illustrates the massive array of challenges to central banking—most of which, effectively insuperable—in exhaustive detail. My criticisms, accordingly, are few—and barely reach the level of a cavil. In Chapter 2, "Knowledge Problems with Discretionary Monetary Policy," the authors comment that

> [t]he alleged advantage of discretion over rules is that discretionary policymakers can use the most recent models and data, and can act in a way that fits the particulars of the situation. But given the demonstrated unreliability and contradictions of real-time data, the argument for discretionary central banking ultimately boils down to trusting and empowering the judgment calls of monetary authorities. Given that the

> data on which the central bankers have to draw is inherently noisy, this is a dubious proposition at best.

It was frankly surprising to see not even a passing reference to Oskar Morgenstern here, given his noteworthy and wide-ranging research program focusing upon the quality of economic data. On page 33, for example, the authors note that for central bankers, snags may arise with simple definitions.

> It is often difficult to define...indicators, let alone agree on an indicator. The very definition of money, for instance, is open to interpretation. As Kay and King (2020, p. 96) write, "But central banks report many different quantitative measures of 'the money supply' and the expression M in a mathematical model is as imprecise as the confused references to 'money supply' in much popular writing.

And later,

> The variety of forms money can take makes it difficult for economists to even form a consensus of which assets count as money (Goodhart 1989, pp. 25, 155; Laidler 1993, pp. 93–98; Lombra and Moran 1980; Mason 1976). The demand for money can manifest itself in demand for cash balances, checking accounts, money market funds, certificates of deposits, stocks, bonds, durable consumer goods, and in new financial products (Alvarez and Lippi 2009; Butos 1986, pp. 93-93; Laidler 1993).... Even after a decade over they were introduced, economists still cannot agree on whether digital currencies, such as Bitcoin, represent money[.] (pp. 39–40)

Morgenstern (1963) echoed those sentiments in analyzing "wages" as a meaningful econometric variable for comparing income internationally.

> Yet wages are not easily ascertained.... These payments take into consideration time worked, overtime, premiums, etc., and are therefore not simple entities. The wage costs (to the company) cannot be easily inferred from these cash payments since they include such fringe benefits as company contributions to pension funds, housing, paid vacations, the value of tenure coupled with automatic increases, etc. As these factors become more important the comparisons (overtime, or among countries with different such practices) of mere money wage rates tend to be of increasingly doubtful value.

Examination of the accuracy of economic statistics and its impact upon policy has been carried on more recently as well. Some of the researchers are familiar to Austrian School adherents, including Higgs (1998) and Bagus (2011); some are less recognizable, such as Boumans (2012) and Linsi and Mügge (2019). While not a ruinous omission by any means, a brief but more detailed discussion of specific shortcomings of economic data and measurement in the context of monetary policy might provide a fruitful starting point for students and economic practitioners less familiar with such issues alike.

To the extent that the supply of bitcoin is algorithmically generated, it would seem to meet all of the criteria set by the authors as a manifestation of desirable "law:" it is generally applicable, wholly predictable, and reasonably robust. While that is surely known to the authors, no mention is made of it. Indeed, although he was speaking metaphorically, Friedman's "monetary computer" analogy referenced in Chapter 5 ties both to bitcoin and issues of technocratic discretion.

> In a broad sense, the Bitcoin economy implements a variant of Milton Friedman's (1960, p. 90) "k-percent rule"—that is, a proposal to fix the annual growth rate of the money supply to a fixed rate of growth.... It remains unclear whether decentralized cryptographic currencies can be designed with monetary policies that include feedback or even discretion. Bitcoin's design embodies a basic version of monetary policy that does not consider the state of the real economy.... The blockchain thus lays the groundwork for automatic monetary policy based solely in nominal data, but does not facilitate any policy based on real economic activity. Human arbiters could presumably add information about economic conditions or could introduce discretion by judgment, but they would also introduce the governance questions Bitcoin set out to overcome.

Having said that, bitcoin and other cryptocurrency assets constitute woeful money, at least currently. It might have been interesting to point to this, nevertheless.

Finally: the book left this reader with a slightly uneasy feeling about the future. When one considers the broad trend of government encroachments upon the liberty of American citizens despite the existence of the US Constitution, three possible conclusions obtain. First, optimistically, that the invasions might have been worse without a standing constitution. Second, that despite good intentions the Constitution has been ineffective in blunting them. And third, that via some combination of gamesmanship among elites and judicial activism the Constitution has actually facilitated the growth of state power. None of those interpretations are particularly comforting. Defeatism is not intellectually productive, but will not any monetary constitution ultimately be flanked, undermined, or simply ignored by clever central bankers, possibly aided by public officials? And even if failure is an eventuality, is that sufficient reason to not attempt to introduce institutional fetters in the meantime?

Again, these are passing quibbles. *Money and the Rule of Law* is a must-read for the monetary scholar. Beyond a discussion of the relationship between monetary policy and the rule of law the book additionally serves as a concise, well-organized, and comprehensive detailing of the plethora of impediments faced not only by central bankers but central planners of all stripes. Perhaps, as the clarion call goes, the Fed will be "end[ed]" someday. (What might replace it, if anything, is yet another issue.) Until then, interim policy measures will be required to suppress or eliminate the pernicious outcomes of monetary tinkering. Boettke, Salter, and Smith have offered an excellent trailhead in this book.

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