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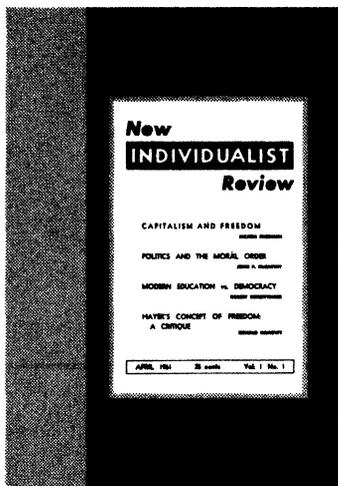
## Monetary Reform and Competition

*by Pamela Brown*



*Ludwig von Mises (1881-1973)*

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# LITERATURE of LIBERTY

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## Editorial

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**I**n Vienna, prior to, during, and just after World War I, Ludwig von Mises (1881–1973) was attaining his full intellectual maturity. For a liberal like Mises these were truly lamentable years. The years from the early 1890s to 1920 constituted perhaps the most retrogressive watershed in the history of Western civilization. They were the years during which the grand liberal system of the Nineteenth Century was overthrown and transformed into Twentieth-Century statism. Saddened, but undaunted, Mises would spend the rest of his life championing the noble but forsaken cause of liberty and liberalism.

By the last decade of the Nineteenth Century, signals were clear that the beginning of the end of the liberal era was at hand. The liberating forces that had been advancing for more than two centuries were grinding to a halt. The New Imperialism, preparation for militarism, and protectionism were replacing both the principles and reality of international peace and free trade. Neo-mercantilism was being reconstructed around the globe.

The liberals knew that the unprecedented prosperity yielded during the heyday of liberalism depended on implementing the free trade plank of the liberal platform. As Mises never tired of pointing out, necessarily central to the free trade system is a sound monetary mechanism to facilitate the policy of free trade. Free trade, sound money, and prosperity are mutually interdependent parts of a single policy.

To pay for military build-ups and for the burdens of neo-colonialization, governments around the world resorted to inflation. Governments and the bankers were once again drawn together into a Neo-Mercantile symbiosis. Inflation, as it always has a way of doing, led to protectionism. Sound money and free trade were left hanging in the balance. The final and decisive blow against the classical liberal order in general and against the international trade and monetary mechanism (the gold standard) in particular was delivered with a vengeance by the Great War.

In the blink of an eye, it was all but gone. The Rights of Man, Peace, Prosperity—all these and the rest of the honored liberal agenda—lay prostrate and smoldering among the ghastly ruins on the battlefields of Europe.

Unfortunately, nearly all of Twentieth-Century history flows directly from this monumental misfortune. The Versailles treaty, the Bolshevik revolution, run-away inflation, the rise of fascism, the Great Depression, exchange controls, autarkic trading blocs, the destruction of international trade and its monetary mechanism (the gold standard), the Second World War, the Cold War—this entire brood of evils emanated from World War I. At every

turn, statism; and at every turn Mises was there to debunk and refute each statist measure and more particularly the collectivist philosophy that lay behind the interminable measure-after-measure of statist intervention.

Even before the Great War, Mises had achieved a significant measure of international acclaim with the publication of his *Theory of Money and Credit* (1912). In it, Mises performed the monumental task of, in effect, completing the subjectivist revolution in economic theory by unifying all economics into a general microeconomic framework. Mises demonstrated that there is no realm of so-called macroeconomics separate from micro theory, one which requires a separate policy. The policy in all areas of economics, as Mises showed, must be *laissez faire* across the board and with no exceptions. This means a total separation of public finance from the banking industry. It means there must be no central bank to service the desires of the government's treasury department. It means a policy of free banking.

Matters of money and monetary theory were to remain of central concern to Mises throughout his long and distinguished career. As an economist, Mises knew that money was the life blood of an advanced, progressive, industrialized economy. Without a sound monetary system, an advanced industrialized economy could not for long function. (On this see Mises' critique of central economic planning under socialism in his seminal 1920 article "Economic Calculation in the Socialist Commonwealth.") Furthermore, Mises knew that sound money served as the necessary core of the international division of labor and international trade mechanism. As an economist and historian, Mises realized that the gold standard was not the creature of governments, but rather had developed through centuries of expanding international commerce and trade. The gold standard was the free market's spontaneous answer, via commercial and merchant banking practices, to the international market's trade needs.

As a liberal, Mises saw the gold standard, along with constitutions and bills of rights, as an integral element in the Classical Liberal political program for protecting the people from the avaricious designs of governments. To a very considerable degree, a hard money policy kept at a minimum the relationships between public finance and national banking systems; it forced the governments of the world to refrain from tampering too terribly much with the people's money through inflation. During the height of the gold standard, if governments wanted to gain more control of the people's wealth they had to resort to naked taxation for redistribution and not hide behind the monetary veil of inflation. Sound money was every bit as much a protection of civil liberties as was the right of free speech or of assembly. As such, it was an irritating impediment to governments everywhere, and

sound money was one of the first building blocks in the liberal edifice to be ruthlessly discarded by all governments during this period.

Mises' first detailed written reflections as a liberal social and political analyst (as distinct from an economist narrowly defined) were published in 1919 in an extraordinarily prescient and just recently translated work, *Nation, State and Economy*. According to many, it ranks with J.M. Keynes' *The Economic Consequences of the Peace* as the most prophetic and sound liberal analysis of the causes and consequences of the war. *Nation, State and Economy* is replete with social, political, and economic insights, many that would occupy Mises' attention during the following half century: the causal interrelationships between private property, the division of labor, free trade, and peace; the absurdities and inadequacies of socialism as a mode of social and economic organization; and, most importantly for our purposes, Mises extended his lifelong investigations into the distorting effects that inflation has on the real structure of production. In this work he is particularly interested in exposing the distorting effects of inflationary-financed military expenditures.

From immediately after the World War to the end of his life Mises never stopped calling for monetary reconstruction and reform. In the long run, for Mises, the most deleterious effect of the war was destruction of the international monetary order. Without sound money there could be no serious hope of disciplining governments to keep them within the bounds of their budgets. In short, Mises foresaw that, without sound money, the Twentieth Century would become an Age of Inflation.

Throughout the 1920s Mises, among many other things, continued his investigations into the relationships between changes in the money supply and the capital structure. This work culminated in 1928 with the publication of Mises' full fledged theory of the Trade Cycle in *Monetary Stabilization and Cyclical Policy*. His theory was a brilliant combination of his own work in monetary theory with key contributions found in the works of Wicksell and Böhm-Bawerk. This theory was then taken over by Mises' most famous student, F.A. Hayek, and expanded and developed into what is now known as the Austrian theory of the trade cycle.

With the publication of *Nation, State and Economy* in 1919, *Socialism* in 1922, *Liberalism* in 1927, and *Critique of Interventionism* in 1929, Mises established himself not only as a great economist but also as a political philosopher and social analyst of the first order. But perhaps more than anything, by the late Twenties Mises was well established as *the* voice of uncompromising liberalism in Europe.

But, as fate would have it, the Thirties were not good times for liberals or liberalism. The Great Depression served as a magnet to

draw statist bromides, policies, and exponents from out of the woodwork. Keynesianism swept the English speaking world just as Fascism swept the Continent. The intransigent and prolific Mises never ceased in his warnings or in championing his liberal cause, but few were willing to listen. By the mid-Thirties, Mises had to flee his beloved Vienna for Geneva, where he set to work on what was to become his major theoretical work in economic science, *Nationaloekonomie* (1940), later to be reworked into the major English treatise, *Human Action* (1949). As the second European conflagration began, Mises and his wife Margit left Geneva for America, where they would spend the rest of their lives.

Although Mises' reputation, along with liberalism in general, waned considerably during the Thirties and Forties, his influence can nevertheless be seen in postwar Europe. Italy's most successful President, Luigi Einaudi, was strongly influenced by Mises as were Wilhelm Roepke and Ludwig Erhard (the masterminds behind the economic Miracle in West Germany), and Jacques Rueff, who presided over the 1959 currency reform in France.

It is perhaps true that Mises' long-run intellectual leverage is greater now than at any time in his own lifetime. Hundreds of young economists and neo-liberals are now hearing about Mises and reading his numerous works. The Mises resurgence is a part of a wider resurgence of interest in both Austrian economics and liberal political economy that began a decade ago and shows no signs of receding.

As has been pointed out in this editorial, central to Mises' economic and liberal thought was his abiding interest in monetary reform in general and free banking in particular. We are pleased to help facilitate this dialogue by publishing the first of what we hope will be several essays on money and monetary reform.

Finally, in honor of last year's Mises centenary, we should like to remind the reader of some of Mises' most important and lasting contributions to economic science and liberal thought:

- (1) On Monetary Theory: *The Theory of Money and Credit; On the Manipulation of Money and Credit.*
- (2) On Liberal Thought: *Nation, State and Economy; Liberalism.*
- (3) On Social Theory: *Socialism; Bureaucracy.*
- (4) On Political Economy: *Critique of Interventionism; Planning for Freedom; Omnipotent Government.*
- (5) On Economic Method: *Epistemological Problems of Economics; The Ultimate Foundation of Economic Science; Theory and History.*
- (6) On General Economic Theory: *Human Action.*

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**Bibliographical Essay**

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# **Constitution or Competition? Alternative Views on Monetary Reform**

*by Pamela J. Brown*  
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## **I. Money: Medium of Exchange or Policy Instrument?**

**M**oney, for practically as long as it has existed, has been employed to realize two fundamentally different sorts of goals: production or plunder. In a market economy, private individuals routinely use monetary institutions in a cooperative way to achieve voluntary exchanges of goods and services. Political authorities, by contrast, use monetary institutions in a non-cooperative way to achieve involuntary transfers of wealth.

As a means for realizing cooperatively achieved ends, the use of money signals a great social advance over its predecessor, direct barter exchange. Carl Menger provided the classical invisible hand or spontaneous order explanation of the process of natural social evolution from barter to commodity money.<sup>1</sup> The emergence of money was an unplanned or "spontaneous" event. No one person invented money; it gradually evolved as individuals, seeking to minimize the number of barter transactions necessary to obtain the commodities they wanted, learned that certain goods were

more marketable than others and began to accumulate trading inventories for the exclusive purposes of exchange.

Money's usefulness as a general *medium of exchange* is clear in contrast to the inconvenience of direct exchange: money eliminates the would-be trader's need to search among the sellers of the commodities he wants to acquire in order to find those few sellers who, in turn, want to acquire the particular commodity or service that he has to offer. The use of money thereby serves, in the words of Karl Brunner and Allan H. Meltzer, as a "substitute for investment in information and labor allocated to search."<sup>2</sup> Brian Loasby aptly comments: "Money, like the firm, is a means of handling the consequences of the excessive cost or sheer impossibility of abolishing ignorance."<sup>3</sup> It may be added that money, again like the firm, permits a far greater degree of specialization and division of labor because it reduces the need to search through markets. Without the institution of money, the modern economy could hardly have grown to its current level of complexity.

The use of money as a medium of exchange brings with it the widespread practice of quoting prices in a common currency unit. As a consequence, money becomes a tool of economic calculation—a "*means of appraisal*" in addition to its medium-of-exchange role as a "means of adjustment." It facilitates the formation of economic plans as well as their execution.

The corrective feedback processes of a complex exchange system crucially depend upon these social functions that money performs. The informational and operational constraints that block both the individual decision-maker and the whole economic order from better coordination of plans would be far more severe had not the institution of money spontaneously emerged. The emergence of money was itself an adaptive response to those obstacles.

The single most important book which has to date been written on the subject of money is Ludwig von Mises' *Theory of Money and Credit*, first published in 1912. If the reader wanted to read just one work for general instruction, this would be the text to choose. It offers still today the most comprehensive and sophisticated system of theory on monetary phenomena. There are of course a number of other important works discussing the nature, evolution, and functions of money.<sup>4</sup>

In its contrasting role as a means for realizing non-cooperative ends, a government-issued circulating currency provides political agencies with an instrument for redistributing wealth. Wealth transfers are achieved through the manipulation of money and credit production, specifically through the injection of new money.<sup>5</sup> For its first spenders the new money represents fresh

additional command over goods and services; but, as the monetary injection does nothing to increase the available supplies of goods and services, the first spenders' command of these goods and services comes at the expense of other participants in the monetary economy. Such money-facilitated government interventions may either transfer wealth from one group of private individuals to others within the private sector of the economy, or transfer wealth to the government itself from the private sector as a whole, depending on whether the initial recipients of the new money represent public or private agencies.<sup>6</sup> Economists refer to the first type of transfer as the use of "monetary instruments" in pursuit of macroeconomic "policy targets," and to the second as government revenue creation via an "inflation tax."

Discussion of the currently competing theories of macroeconomic policy can be found in a number of textbooks.<sup>7</sup> The books of Arthur Marget, *The Theory of Prices* (1942), and Axel Leijonhufvud, *On Keynesian Economics and the Economics of Keynes* (1968), provide valuable doctrine-historical perspectives on macroeconomic theory. Of the many extensive analyses of the nature and implications of the revenue-generating potential of a government fiat currency monopoly, two works co-authored by H. Geoffrey Brennan and James M. Buchanan deserve special attention: "Money Creation and Taxation," which appears in *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (1980); and *Monopoly in Money and Inflation: The Case for a Constitution to Discipline Government* (1981).<sup>8</sup>

One point is worth noting in passing. There seems to exist a unidirectional ('one-way street') dependence between the feasibility of utilizing a currency's universal acceptability for facilitating economic exchange and the feasibility of exploiting this property for political ends. In other words, it appears possible for money to serve the needs of market participants without at the same time necessarily having to serve the interests of political agencies; yet it seems impossible for money to serve the non-cooperative currency controller without it already having been adopted for use by the cooperative social order. The relationship, in other words, is like that of host to parasite.<sup>9</sup>

## II. The Problem Plaguing Monetized Systems: Government Mismanagement of Currency Production

As S. Herbert Frankel has noted in his *Money: Two Philosophies; The Conflict of Trust and Authority* (1977), the cooperative and non-cooperative uses of money do not simply coexist peacefully. There exists a "trade-off" between the cultiva-

tion of a monetary order best suited to the purposes of *microeconomic* adjustment (processes based on the ability of individuals to calculate and exchange effectively), and the manipulation of the monetary system to achieve *macroeconomic* adjustment. Government impairs monetary reliability (i.e., the reliability of money price signals for calculation and exchange) when it manipulates money and credit flows in pursuit of "full employment" levels of output. Frankel has described the situation as one of "conflict between money as a tool of state action and money as a symbol of social trust."<sup>10</sup>

Crucial to the economic usefulness of money is the *predictability* of its exchange-value or purchasing power. The greater the general stability of monetary conditions of the economy, the more efficiently does resource allocation based upon subjective valuation and availability of economic goods take place. *Unpredictability* in the value of the money unit, on the contrary, is the quality of a money that proves most valuable for political purposes. Government may most profitably expand the number of money units in circulation when the inflationary consequences are unanticipated, especially by the economic sectors which are destined to experience the greatest loss of wealth due to the actions of the authorities. Where inflationary expectations of market participants underestimate the effects of politically expedient monetary disturbances on the system, the resulting changes in the distribution of wealth and income, and the unanticipated transfers of capital, are an indication that political goals are, by a crude process, being achieved at the expense of economic ends. Alternatively, if such monetary manipulations for political purposes are being *unsuccessfully* executed, this may indicate that individual agents in the market sector are successfully anticipating and, as a result, guarding themselves against movements in the currency's purchasing power. In this event, economic activities requiring the use of money are then succeeding at the expense of political programs.

In sum, the economic role of money within the market order is that of a general means serving no *one* particular end but rather an ever-changing *set* of private ends.<sup>11</sup> In order for this role to be most efficiently filled, the value of the money unit must be stable, or, at least predictable. By serving "economic" interests, money serves *social* interests in general.

In its political role, however, currency serves as an instrument to advance special interests. Unlike the market function of money, the political function of money is not end-independent, but end-specific. Whether the end consists of implementing full-employment policy or creating revenue, monetary systems that have been set up to permit manipulation of the money stock for the benefit of special rather than general interests tend to sys-

tematically destabilize the market. The resulting disturbances are the consequence of the falsification of economic calculations caused by price distortions. The distortions, in turn, result from the unpredictable changes in, and consequent uncertainty about, the structure of relative prices affected by policy decisions.

Several important works by economists and accountants have discussed the negative consequences of monetary expansion undertaken for political ends, as those consequences fall on particular private groups or individuals.<sup>12</sup> Others have considered the burden of such manipulations in terms of their disruption of the overall orderliness of a monetized exchange system.<sup>13</sup> Axel Leijonhufvud has cogently summarized the way in which inflationary monetary policies interfere with microeconomic coordination:

Transactors will not be able to sort out the relevant "real" price signals from the relative price changes due to . . . inflationary leads and lags. How could they? Messages of changes in "real scarcities" come in through a cacophony of noises signifying nothing . . . and "sound" no different. To assume that agents generally possess the independent information required to filter the significant messages from the noise would . . . amount to assuming knowledge so comprehensive that reliance on market prices for information should have been unnecessary in the first place.<sup>14</sup>

The economics profession generally acknowledges that use of monetary policy for full-employment purposes involves some sacrifice. There is little consensus, however, concerning the nature and significance of this "trade-off." The properties of the "Phillips curve"—the graphic representation of a supposed trade-off between lower inflation and lower unemployment—have been the subject of extensive theoretical and empirical investigation. Economists of the Austrian School have recently been joined on one issue by those of the Monetarist School, and especially the "Rational Expectations" wing of the latter. Both groups advance the proposition that any increase in output or employment that is induced by monetary expansion must be temporary and self-reversing. Such an increase results only from mistaken actions influenced by the false price signals generated by the monetary expansion. Unexpectedly rapid money growth may bring greater measured output and employment today, but it does not bring greater output or employment tomorrow, and is indeed likely to depress aggregate productivity in the long run due to its structurally disruptive impact.<sup>15</sup> Unquestionably, it brings greater inflation of prices.

The contrary belief that discretionary money and credit management can achieve positive policy outcomes has been associated with Keynesian economic thought. The literature in support of discretionary policy is vast, as is the literature in opposition.<sup>16</sup> The issue is still very much alive in the economic journals.

The questions of the *feasibility* of generating (short-run) increases in employment and output through monetary expansion,

and of the consequences of such a policy for the (long-run) reliability of money and money price signals, are matters for an impartial *wertfrei* economic science to investigate. However, the question of the relative *desirability* of such various policy-dependent outcomes, no matter what theoretical and empirical propositions one may accept, calls for a normative, value-oriented appraisal. The non-value-free nature of such an appraisal might have been emphasized by placing between quotation marks the words “problem” and “*mismanagement*” in the subtitle above.

A preference for long-term stability in the purchasing power of a community’s monetary unit—as opposed to policy-induced changes of dubious duration in levels of aggregate resource utilization—is a major impetus behind recent arguments for reform of existing monetary arrangements. An even greater impetus to reform is a perception of the injustice inherent in a system that enables those in authority to systematically plunder the real wealth of the citizenry via an “inflation tax”—clearly a most insidious form of “taxation without representation.” Economists in the field of monetary political economy have concluded that an extremely serious problem of design exists in the present organization of the governmentally controlled money supply system. In their view the money-using public’s demand for long-term monetary stability is not being met. The task remaining for specialists in the field is therefore clear: to discover and develop a more appropriate means for realizing of the goal of monetary stability.

Let us now consider what these writers have proposed.

### III. The Proposed Remedies to Bureaucratic Corruption of Token Currency

#### A. Gold: A Note on the “Classical” Solution

The oldest and certainly most familiar solution to the corrupting effects of state-controlled paper money is a return to a gold standard. To many of us, the idea of reintroducing the use of specie (coined precious metals) and specie-convertible bank liabilities as exchange media is practically synonymous with a return to stable money. The essential virtue of a monetary system based on “hard” currency is perhaps best expressed by one of the leading proponents of the gold standard, Hans F. Sennholz. He writes, in his *Inflation or Gold Standard*:

It is undoubtedly true that the fiat standard is more workable for economic planners and money managers. But this is the very reason why we prefer the gold standard. Its excellence is its *unmanageability* by government. And we also deny that the fiat standard, which is characterized by rapid self-destruction and has failed wherever it was tried,

compares favorably on purely scientific grounds with the gold standard, which is as old as man's civilization. Out of the ashes of fiat money the gold standard always springs anew because it is no technical creation of a few expert advisers, but a social institution that flows from economic freedom and economic law.<sup>17</sup>

As anyone pursuing the question of monetary reform soon discovers, a mountain of literature—both popular and technical—has been published over the years on the nature and benefits of commodity money. Ludwig von Mises, in *The Theory of Money and Credit*, has deeply explored the distinctions among the three types of money: commodity money, credit money, and fiduciary, fiat, or “token” money. Of late, the leading advocates of the reinstatement of a gold standard have included Murray N. Rothbard, Henry Hazlitt, and Hans F. Sennholz.<sup>18</sup>

Of related interest is the concept of a “commodity reserve” currency convertible not into coin but into a wide “basket” of standardized goods. Unlike a gold coin standard, a commodity reserve system would necessarily have to be the technical creation of a few expert advisers. This proposal has been discussed by Friedrich Hayek and Milton Friedman among others.<sup>19</sup>

Although much has been written on the pros and cons of a return to gold as the solution to the chaos of politically controlled fiat money, this classic debate will not be considered in further detail here. Instead we turn to reform proposals *not* based on re-establishment of convertibility for government-issued currencies. In this context, two alternative means of preventing continued government mismanagement of currency production have been suggested: imposing legislated constraints on the behavior of the monetary authority or, more radically, abolishing the government's monopoly in currency production. An extremely significant literature has grown up in recent years out of the debate between these two camps concerning the most appropriate structure for a purely token money system. The first group supposes continued government monopolization, while the second argues for a free market in the issue of private currency.

## **B. Monetary Rules:**

### *The Call for a “Constitutionally Constrained” Government Monopoly*

The by-now-mainstream response among monetary economists to the need for reform of the existing currency arrangements is the proposal that a “monetary constitution” be constructed and imposed upon those authorities who are vested with the responsibility for managing the nation's money supply.

Such a "constitution" would lay down binding rules defining in detail the money-supply procedure to be followed. Fundamental to this program is a perpetuation of the existing market structure in currency production, namely government-run or nationalized monopoly.

At present, the United States clearly lacks any explicit legal rule restricting the federal government's money-creation behavior. Indeed, it lacks even *general* constitutional limitation upon governmental efforts to "manage" the economic system overall. As Neil H. Jacoby notes, "It is a remarkable fact that the federal Constitution says practically nothing about the role of the President in guiding the national economy. Present institutions of control have evolved outside the Constitution and to a considerable extent outside of federal statutes." Jacoby conjectures that the Founding Fathers neglected "problems of economic stabilization" due to the fact that [s]uch problems did not exist in the predominantly rural and agricultural society of about four million souls that was the United States in 1789.<sup>20</sup>

Existing statutes concerning the federal government's control over the monetary system are so vague that they may be interpreted in almost any fashion. They are therefore of little help in legally constraining the monetary authorities. This ambiguity is apparent in the original Federal Reserve Act of 1913, which broadly directed the monetary authorities to regulate the nation's currency so as to "accommodate commerce and business."<sup>21</sup> The Act was initially designed to guide the authorities within the context of the gold reserve standard that existed at the time. The elimination of the gold standard brought about by World War I, however, rendered the Act inadequate to constrain bureaucratic behavior.<sup>22</sup>

With the end of the gold standard, money-creation authorities in the United States and other nations became free to follow more "activist" macroeconomic policy measures. The Keynesian intellectual underpinnings of such monetary policies as they have evolved in the last half-century have been dissected by "Public Choice" economists James M. Buchanan and Richard E. Wagner, and by Austrian economists F.A. Hayek and Murray N. Rothbard.<sup>23</sup>

### *Two Rationales for Rules*

As already suggested, the various programs that monetary constitutionalists have proposed rest on two basic planks. First, they propose to maintain the existing government-run monopoly of the currency industry. Secondly, they advocate that a binding money-creation "rule" be imposed on the monopoly authority. As

we shall see below, a number of different rules have found advocates.

Imposing a strictly defined and inflexible rule of monetary discipline, of whatever kind, is taken by monetary constitutionalists to represent "nothing more than the replacement of an undefined and potentially biased system of monetary policy by a defined system."<sup>24</sup> They share the belief, as expressed by Milton Friedman, that "the monetary structure needs a kind of monetary constitution, which takes the form of rules establishing and limiting the central bank as to the powers that it is given, its reserve requirements, and so on." By defining the "rules of the game" of currency production, the monetary constitution will supposedly require that the government execute plans affecting the money supply "by law instead of by men." It will remove the "extraordinary dependence on personalities, which fosters instability arising from accidental shifts in the particular people and the character of people who are in charge."<sup>25</sup> As a result, such a monetary constitution will greatly diminish the wide fluctuations in economic activity which in the past have allegedly resulted from "the granting of wide and important responsibilities that are neither limited by clearly defined rules for guiding policy nor subjected to test by external criteria of performance."<sup>26</sup>

Before discussing some of the specifics of the various monetary constitutionalists' programs for institutional reform, it is interesting to note that there appear to exist two very different theoretical rationales behind the advocacy of these reforms.

Many proponents of a binding monetary rule argue for its necessity on the grounds that those in control of the currency production apparatus are faced with insurmountable limitations of knowledge. They argue that the authorities' inability to forecast precisely the lagged responses of the economic system to their policy actions renders the achievement of monetary stability via discretionary "fine-tuning" technically impossible. Given the present state of knowledge, then, some sort of inflexible and binding managerial "constitution" is perhaps the most reasonable procedure available. Most notable among those advancing this "informational limitations" argument are the Monetarist authors Phillip Cagan, Anna J. Schwartz, and Milton Friedman. Friedman expresses this position in the following way:

[A "simple" monetary rule] is also likely to strike many of you as simple-minded. Surely, you will say, it is easy to do better. Surely, it would be better to "lean against the wind," in the expressive phrase of a Federal Reserve Chairman, rather than to stand straight upright whichever way the wind is blowing . . . [T]he matter is not so simple. We seldom in fact know which way the economic wind is blowing until several months after the event, yet to be effective, we need to know which way the wind is going to be blowing when the measures we take now will be effective, itself a

variable date that may be a half year or a year or two years from now. Leaning today against next year's wind is hardly an easy task in the present state of meteorology.<sup>27</sup>

An alternative framework for analyzing the problematical behavior and consequences of an "unconstrained" government monopoly in currency production, though it leads to the same policy conclusions, has been developed and utilized by James M. Buchanan and other Public Choice theorists.<sup>28</sup> These writers emphasize the monetary authorities' *motivational* shortcomings, rather than their informational limitations. The authorities, according to this viewpoint, actually lack the proper *intentions* to be allowed to exercise discretionary powers in the day-to-day management of the supply of currency. Buchanan and H. Geoffrey Brennan, for example, base the case for a rule constraining government's currency-creating activities on "government behavior in the 'worst-case' setting," a setting in which the "natural proclivities" of politicians and bureaucrats predominate. The "natural proclivities" of political functionaries involve, according to these theorists, the tendency to make decisions and take actions based upon a "narrowly-defined self-interest" which "run[s] counter to the basic desires of the citizenry."<sup>29</sup>

Richard E. Wagner argues in the same vein: "Existing monetary institutions create a link between politics and monetary control. The consequence of monetary monopoly combined with the pursuit of political self-interest can be macroeconomic discoordination." More specifically, given the government's notorious and seemingly irresistible tendency to consistently overspend and contribute annually to an already enormous federal deficit, its monopoly over the production of currency "alters the constraints within which government conducts its activities, and alters them systematically by creating the bias toward monetary expansion."<sup>30</sup> As Gordon Tullock notes, monetary administrators are

... people who have no great security of tenure. Under the circumstances, maximizing the present value of income over the next few years, rather than over the entire income stream, is their objective. In general, inflation is a better way of achieving this objective than is an effort to give a good reputation to your currency . . . <sup>31</sup>

In short, monetary systems granting monopoly privileges and permitting the wide use of discretion to those in power will most certainly function in a manner which maximizes the prospects for achieving political ends through monetary means. As a result, such systems tend to do "maximum, rather than minimum violence, to the logic of the market economy, sufficing to transform it from a harmonious to a self-destructive system."<sup>32</sup> As Wagner has emphasized, "it is contrary to reason and to history to expect that

a monopoly position will fail to be exploited for the benefit of those in a position to practice such an exploitation.”<sup>33</sup>

### *Suggestions Concerning the Rule's Content*

Constitutionally constrained monetary systems are, as John Culbertson defines them, “token money systems with explicitly defined behavioral properties.” Various monetary rules differ according to the particular economic variable whose behavior is singled out for explicit control. There are basically two sorts of rules: (1) those that focus on the behavior of some monetary statistic, such as Milton Friedman’s well-known proposal for a fixed annual growth rate in some measure of the stock of money; and (2) those that focus on the behavior of some non-monetary statistic, such as proposals for stabilizing the price level or interest rates. In either case, the monetary authority is required to manipulate the monetary variable(s) under its immediate control—for the Federal Reserve System this is the sum of currency plus bank reserves—so as to keep the economic “target” variable on track.

Upon closer examination of proposals involving the first sort of rule, it becomes evident that their long-run aim is usually identical to those rules which directly focus on maintaining a constant consumer price index. Friedman’s proposal, for example, calls for a three to five percent annual growth rate in a particular measure of the money stock. This growth-rate interval is chosen, he acknowledges, “so that on average it could be expected to correspond with a roughly stable long-run level of final product prices . . . A rate of 3% to 5% per year might be expected to correspond with [such a] price level.”<sup>34</sup> Elsewhere Friedman argues that the “optimal” growth rate of the quantity of money would be that rate expected to correspond with a *falling* price level, specifically a price level falling at a percentage rate equal to the real rate of interest.<sup>35</sup>

Friedman and others have extensively discussed the details of possible programs incorporating a constant-money-growth-rate rule.<sup>36</sup> E. S. Shaw has elaborated a version of the program specifying a 4% growth rate.<sup>37</sup> In all cases, inflexibility inherent in such programs has come under criticism. Martin Bronfenbrenner claims greater efficiency on behalf of a “lag” rule, “according to which the growth rate of the money supply is adjusted to prior fluctuations in the growth rates of real national output and the velocity of the circulation of money.” He argues that such a rule “may be worthy of consideration as a compromise between the rigidity of the Friedman-Shaw proposals and complete reliance on that combination of forecasting ability, political pressure,

and administrative routine which passes as 'judgment' or 'discretion.'<sup>38</sup> Other writers suggest that the rule adopted should be a "flexible" one, containing "override provisions" which permit it to be subjected to "frequent review" and "modification . . . as may be needed for maintenance of stability in the value of money."<sup>39</sup> Yet inflexibility also has its defenders. They contend that the monetary rule, once put into operation, should function so "mechanically" and serve its purpose so effectively, that "hereafter, we may hold to it unrationally—on faith—as a religion, if you please."<sup>40</sup>

Several authors have proposed and examined rules which constrain the monetary authorities by directing them specifically to maintain a constant price level rather than a constant money growth rate. Foremost among these authors are Jacob Viner, Henry Simons, Clark Warburton, and William H. Hutt.<sup>41</sup> James M. Buchanan's prescription for monetary management more broadly emphasizes predictability rather than simple constancy in the level of money prices.<sup>42</sup>

The number of different monetary rules which could be devised is virtually infinite. Those which have been engineered to date suggest just a few of the many possibilities. Yet, despite disagreement among these theorists on the specific content of the constitutional constraint proposed, unanimity reigns concerning the necessity and importance of the constitutional construct itself. All would agree with Milton Friedman where he writes,

The main point . . . is not so much . . . the *content* of these or alternative rules as to suggest that the *device* of legislating a rule about the stock of money can effectively achieve what an independent central bank is designed to achieve but cannot. Such a rule seems to me the only feasible device currently available for converting monetary policy into a pillar of a free society rather than a threat to its foundations.<sup>43</sup>

### *Suggestions Concerning the Money Monopoly's Organization*

The passing years have witnessed numerous and detailed suggestions concerning the specific content of a constitution or rule that would define the appropriate procedure for money creation and control. The same cannot be said, however, of recommendations concerning the internal organization of the currency management apparatus. Although monetary constitutionalists concur on the necessity of concentrating the control of the currency industry in the hands of a single producer, there have been few detailed suggestions concerning this monopoly's specific setup and day-to-day internal operation. Henry Simons, in his classic article, "Rules Versus Authorities in Monetary Policy," proposed placing the money-creation power presently "dispersed indefinitely, among governmental agencies and private institu-

tions, not to mention Congress itself," under the jurisdiction of the Treasury, which might then be "given freedom within wide limits to alter the form of the public debt—to shift from long term to short term borrowing or vice-versa, to issue and retire debt obligations in a legal tender form."<sup>44</sup> In order to "eliminate . . . the private creation and destruction of money," Milton Friedman suggests that the right to produce and control the supply of token units in circulation be granted exclusively to "the Central Bank" or "the Reserve System."<sup>45</sup> In general, though, the various authors offer no clear prescriptions concerning the possible internal structure or appropriate bureaucratic characteristics of the monopoly agency that they advocate. W. H. Hutt merely refers to "a monetary Authority,"<sup>46</sup> without giving details on the possible nature of this agency, while H. Geoffrey Brennan and James Buchanan speak simply of "government," in their recent book *The Power to Tax*. Lack of descriptive precision on this matter is not surprising, however, since the monetary constitutionalists believe that the content of rule constraining the privileged producer, rather than the set-up of the producing agency, is crucial to the success of their proposals.

### *The Anticipated Results of a Monetary Constitution*

With constitutionally constrained monetary management, its advocates contend, the currency industry will no longer be a primary source of uncertainty and structural discoordination for the economy. Instead, the management will conduct its activities in such a way that monetary conditions become economically "neutral," permitting the emergence of what John M. Culbertson refers to as a "zero-feedback" monetary system. Such a system does not add to "the net positive feedback of the economic system" which tends to make it "prone to excessive self-feeding movements" away from equilibrium. It does not create inflations and recessions in the name of stabilization policy. Instead it allows the "financial side of the economy" to operate as the "feedback-control" or coordinating mechanism.<sup>47</sup>

In sum, the legislation and enforcement of a monetary constitution, by appropriately restricting the actions of those with jurisdiction over the money production apparatus, will, it is believed, create a framework wherein the circulating medium behaves in harmony rather than in conflict with the exchange system.

### **C. A Free Market Money System: The Competing Currencies Alternative**

For decades, programs for a rule-restrained government monopoly had no serious rivals in the area of proposals for reform

of the existing, politically dominated monetary system. In the literature of monetary policy, the constitutionalists' suggestions were the only seriously proposed alternative to the *status quo*—the gold standard aside—that promised to insure stability in the circulating medium's exchange-value. Then, in 1976, F.A. Hayek published a short but professionally shocking book entitled *Denationalisation of Money: An Analysis of the Theory and Practice of Concurrent Currencies*. Hayek seriously proposed the exciting, challenging possibility of a spontaneous monetary order providing for its own token currency needs, without the involvement of government. The result was a major explosion of research into this new—*free market*—alternative to the state's historically exclusive right to issue currency for the economy.

### *From "Bitter Joke" to "Crucial Issue"*

First presented by Hayek "as a sort of bitter joke,"<sup>48</sup> the proposition that the free market might provide the best institutional vehicle for the production of monetary services has emerged as the single most important development in the area of monetary reform in recent years. This free market approach to money is not to be confused with the so-called "Free Money" policies advocated earlier in this century by such inflationists as Silvio Gesell in *The Natural Economic Order* and Henry Meulen in *Free Banking, an Outline of a Policy Individualism* (1934). Those policies were designed to permit abundant rather than *sound* private monies. The program behind the "Free Money Movement" called for by Hayek requires, by contrast, nothing less than a radical switch from the government's traditionally closed monopoly in the token currency industry to a regime of free trade in the production and choice of exchange media. Hayek would allow government to continue to produce currency only as one competitor among many: "What is so dangerous and ought to be done away with is not governments' right to issue money but the *exclusive* right to do so and their power to force people to use it and accept it at a particular price."<sup>49</sup>

Proponents of free trade in currency predict that a program for monetary reform which places *competitive* rather than "constitutional" constraints on the individual money producer will prove to be far more effective in orienting managerial activities toward satisfying the needs of a currency-consuming public. Given the success of the market system in other realms of production, Hayek argues that the appropriate control of monetary aggregates to meet the demands of transactors "will be done more effectively not if some legal rule forces government, but if it is in the self-interest of the issuer which makes him do it, because he can keep his business only if he gives the people a stable money." Raising the informational as well as the motivation problems of

monetary central planning and nationalization, he adds that "the monopoly of government of issuing money has not only deprived us of good money but has also deprived us of the only process by which we can *find out* what would be good money."<sup>50</sup>

It would be difficult to overstate the seriousness and urgency with which Hayek advocates the denationalization of money as a means for reforming the existing system. He does not propose the end of the monetary monopoly merely as a temporary expedient, to tide us over until we are able to design a constitutional mechanism that will channel the government monopoly into more commendable modes of behavior; nor as a standby plan in case the present system collapses. His alternative of monetary self-organization requires nothing less than the permanent removal of all barriers to entry and free competition in the currency and banking industries. And what is more, it promises nothing less than an end to the catastrophic effects of central-bank-caused business cycles:

It is very urgent that it become rapidly understood that there is no justification in history for the existing position of a government monopoly of issuing money. . . . (T)his monopoly . . . is very largely the cause of the great fluctuations in credit, of the great fluctuations in economic activity, and ultimately of the recurring depressions. . . . (I)f the capitalists had been allowed to provide themselves with the money which they need, the competitive system would have long overcome the major fluctuations in economic activity and the prolonged periods of depression.<sup>51</sup>

*Earlier Advocates of Free Trade in Money:  
From Smith to Spencer*

Earlier discussions of the nature and consequences of a regime of free trade in the money and banking industries may be found in the works of several classical political economists.<sup>52</sup> Adam Smith, for example, in his unsurpassed *Inquiry into the Nature and Causes of the Wealth of Nations* (1776), expressed support for Scotland's policy of *laissez faire* towards the issue and circulation of private bank notes used in commercial exchange. Smith explained that substantial economies could be gained by employing redeemable paper currencies in place of gold and silver coin, as the displaced coin could then be exported in exchange for productive capital goods. Nevertheless, he was also aware of the potential dangers of such paper monies:

The gold and silver money which circulates in any country, and by means of which, the produce of its land and labour is annually circulated and distributed to the proper consumers, is . . . all dead stock. It is a very valuable part of the capital of the country, which produces nothing to the country. The judicious operations of banking, by substituting paper in the room of a great part of this gold and silver, enables the country to convert a

great part of this dead stock into . . . stock which produces something to the country. . . . The commerce and industry of the country, however, . . . though they may be somewhat augmented, cannot be altogether so secure, when they are thus, as it were, suspended upon the Daedalian wings of paper money, as when they travel about upon the solid ground of gold and silver.<sup>53</sup>

The insecurity for domestic banknote users was, in Smith's words, mainly due to "the accidents to which they are exposed from the unskillfulness of the conductors (issuers) of this paper money." Smith's solution, not surprisingly, was free competition:

(The) multiplication of banking companies . . . , an event by which many people have been much alarmed, instead of diminishing, *increases* the security of the publick. It obliges all of them to become more circumspect in their conduct, and . . . to *guard* themselves against those malicious runs, which the rivalry of so many competitors is always ready to bring upon them. . . . By dividing the whole circulation into a greater number of parts, the failure of any one company, an accident which, in the course of things, must sometimes happen, becomes of less consequence to the publick. This *free competition* too obliges all bankers to be more liberal in their dealings with their customers, lest their rivals should carry them away. In general, if *any* branch of trade, or *any* division of labour, be advantageous to the publick, the *freer and more general the competition, it will always be the more so.*<sup>54</sup>

John Stuart Mill, in his *Principles of Political Economy* (1848), also offered arguments for relying—with some qualifications—upon private sector competition in the production of money and banking services. He noted:

The reason ordinarily alleged in condemnation of the system of plurality of issuers . . . is that the competition of these different issuers induces them to increase the amount of their notes to an injurious extent. . . . (But) the extraordinary increase in banking competition occasioned by the establishment of the joint-stock banks, a competition often of the most reckless kind, has proved utterly powerless to enlarge the aggregate mass of the banknote circulation; that aggregate circulation having, on the contrary, actually decreased. *In the absence of any special case for an exception to freedom of industry, the general rule ought to prevail.*<sup>55</sup>

The irrepressible Herbert Spencer, in *Social Statics*, also voiced his support for private enterprise in servicing the public's credit and currency needs. Spencer wrote:

Thus, *self-regulating* as is a currency when let alone, laws cannot improve its arrangements, although they may, and continually do, *derange* them. That the state should compel every one who has given promises to pay, be he merchant, private banker, or shareholder in a joint-stock bank, duly to discharge the responsibilities he has incurred, is very true. To do this, however, is merely to maintain men's rights—to administer justice; and therefore comes within the state's normal function. But to do *more* than this—to restrict issues, or forbid notes below a certain denomination, is no less injurious than inequitable. . . .

When, therefore, we find *a priori* reason for concluding that in any given community the due balance between paper and coin will be *spontaneously* maintained, we have no objection to the state's interposing its laws to secure it.

taneously maintained—when we also find that three-fourths of our own paper circulation is *self-regulated*—that the restrictions on the other fourth entail a useless sinking of capital—and further, that facts prove a *self-regulated system* to be both safer and cheaper, we may fairly say . . . that legislative interference is . . . needless.<sup>56</sup>

### *Recent Discussions of the Competitive Supply of Money*

Scholarly analysis of the properties of a competitive system of privately issued “token” monies—monies *not* redeemable on demand for precious metals—appears to be confined to recent decades. One of the first major theoretical discussions of such a system is William P. Gramm’s “Laissez-Faire and the Optimum Quantity of Money,” which appeared in 1974.<sup>57</sup> Developing a model of the currency industry characterized by a “perfectly” competitive market structure, Gramm counters the claims made by monetary economists Harry Johnson, Paul Samuelson, as well as Boris Pesek and Thomas Saving. These scholars claim that competition in the production of nominal money balances wastes resources and results in a non-optimal quantity of money, implying, therefore, that the currency industry is subject to “market failure.”<sup>58</sup> In his excellent “Theory of Money and Income Consistent with Orthodox Value Theory,” also appearing in 1974, Earl Thompson also analyzes the efficiency and macroeconomic stability properties of a system in which “competitive money creators” or “bankers” supply the needs of currency-using transactors. Thompson demonstrates the beneficial consequences that follow when we properly apply the standard assumptions of orthodox neoclassical value theory to a perfectly competitive production-and-exchange economy in which the provision of money is also subject to perfect competition. The result is an equilibrium quantity of real money balances which is: (1) determinate; (2) “Pareto optimal” (i.e., all resources go to their highest-valued uses); and (3) consistent with Say’s Law of Markets (i.e., inconsistent with permanent, aggregate resource unemployment).<sup>59</sup>

In November of 1974, another major work on the competing currencies question was published in the *Journal of Money, Credit, and Banking*. In his article “The Competitive Supply of Money,” Benjamin Klein dealt the final blow to those arguments against monetary competition. Klein refutes the criticism that such a system would necessarily generate a hyper-inflation, leading to an infinitely high level of money prices. He demonstrates that we could expect such a result only when the “brand names” or “trademarks” of the various privately issued token monies are not protected from counterfeiting. He provides an excellent discussion of the process by which the competitive system would punish a

money-producing firm that attempted to cheat its customers by deceitfully manipulating the supply of its brand of money, and how, correspondingly, it would reward a firm that operated to preserve its customers' trust. Klein concludes with a short historical discussion and a consideration of the pros and cons of competition, but he comes to no strong conclusions concerning the preferability of a competitive market structure over the existing closed government monopoly.<sup>60</sup> In two later articles, Klein applies his theoretical apparatus to the questions of European monetary unification and the seignorage profits earned by currency issuers.<sup>61</sup>

Shortly after Klein's first article, Gordon Tullock's "Competing Monies" appeared in the *Journal of Money, Banking, and Credit* (1975). This fascinating article, after suggesting some possible examples of historical precedents in the use of competing private token issues, offers an important theoretical analysis of the microeconomic process by which a depreciating currency might gradually be given up in favor of another more stable one.<sup>62</sup> Tullock's article triggered an interesting exchange between himself and Klein concerning the authenticity and frequency of historical instances of competing private monies.<sup>63</sup>

### *Hayek and the Denationalization of Money*

F. A. Hayek's 1976 pamphlet, *Choice in Currency: A Way to Stop Inflation*, represented the beginnings of the first major attempt to investigate seriously the *practical* possibilities of a system of competing paper issues. It was here that Hayek began to address the question, "Why should we not let people choose freely what money they want to use?"—and to answer it: "There is no reason *whatever* why people should not be free to make contracts, including ordinary purchases and sales, in any kind of money they choose, or why they should be obliged to sell against any particular kind of money."<sup>64</sup>

The program presented in *Choice in Currency* involves domestic competition among different *national government* monies, each of whose circulation is presently confined almost exclusively to its country of origin. But over a period of eight months, the program quickly evolved into a full-blown scheme of competing *private* (as well as governmental) monies. The result of this development was Hayek's pathbreaking *Denationalisation of Money: An Analysis of the Theory and Practice of Concurrent Currencies*. First published in 1976, this work was subsequently revised and extended.<sup>65</sup> It provides the best existing account of, and the best case for, free competition in the production and control of privately issued token monies. Hayek's analysis of the hypothetical working of a

laissez-faire monetary system may seem deceptively simple, due to its brief treatment of a novel idea. The analysis should be closely read and carefully considered by the interested reader, as it has been misunderstood by more than one writer in the area.<sup>66</sup> The author comes to the firm conclusion that "*the past instability of the market economy is the consequence of the exclusion of the most important regulator of the market mechanism, money, from itself being regulated by the market process.*"<sup>67</sup>

Since Hayek's *Denationalisation of Money* was first published, several other authors have made significant contributions to the small but rapidly growing discipline of currency competition. These include Lance Girton and Don Roper, whose "Substitutable Monies and the Monetary Standard" (1979) gives a clear and concise statement of the "theory of multiple monies" and discusses some of the major issues connected with the choice-in-currencies question.<sup>68</sup> Roland Vaubel's "Free Currency Competition" (1977) is an excellent study offering an extremely thorough overview of the subject and its controversies. In addition, it provides some personal predictions concerning what Vaubel believes to be the most likely outcome of a competitively determined currency industry.<sup>69</sup> Vaubel refers to two as-yet-unpublished works, Wolfram Engels' "Note Issue as a Branch of Banking" and Wolfgang Stutzel's "Who Should Issue Money? Private Instead of Public Institutions? Bankers Instead of Politicians!", that further discuss and argue for a free market in money.

Among lay audiences concern with understanding the existing monetary mess has reached a high level of intensity in recent months. In order to satisfy this popular demand, a number of nontechnical introductory articles on the competing token monies alternative have recently appeared. Among these are pieces by economists Martin Bronfenbrenner, F. A. Hayek, Lawrence H. White, and Peter Lewin.<sup>70</sup> In addition, a number of works have examined historical incidents of privately-issued monies (token, fiduciary, and commodity), complementing research done on the purely theoretical level.<sup>71</sup>

### *The Competitive Process of Currency Production*

The hypothetical day-to-day operation of an established competitive token monetary system is in fact no more (or less) mysterious than is the working of the market process in any other production domain. Private issuers would compete in a number of dimensions to meet the community's demands for monetary services: purchasing-power behavior over time, convenience of use in exchange, convenience of use in accounting, and so on. Depending upon the preferences of currency consumers, the producer would

adjust the existing supply of nominal units of his money so as to provide the appropriate degree of appreciation or constancy in his money's value. The purchasing-power control technique (or "rule") employed in actual practice by any given firm is, under a competitive system, a matter to be determined exclusively by the subjective judgments of the monetary entrepreneur.

Because people's exchange needs are different, preferences with respect to changes in the exchange-value of currencies can be expected to vary over the population of money users. This would result in issuer specialization to meet the unique requirements of particular user interests. Similarly, tastes may differ with respect to the index of commodity prices devised to monitor deviations from the desired level or rate of change of the purchasing power of a money. On this point, Hayek explains: "Experience of the response of the public to competing offers would gradually show which combination of commodities constituted the most desired standard at any time and place."<sup>72</sup> In short, under competitive conditions, the monetary standard, the monetary rule, and the purchasing-power behavior of money are all determined by expressed choice in the marketplace rather than by arbitrary political command.

Over time, those issuers who most effectively satisfy the demand for monetary services would profit and expand their market shares. Others who, for example, increase the value of their currencies when most money-holders prefer stable tokens, or stabilize their monies when most users prefer appreciating tokens, would be driven out of business or be forced to maintain a more modest circulation due to reduced profits. Which sort of monies would actually prove most popular, only the competitive market process can tell. For instance, Roland Vaubel points out, while purchasing-power appreciation tends to enhance a money's desirability as an asset (or "store of value"), purchasing-power constancy may enhance its desirability as an accounting device (or "standard of value").<sup>73</sup>

The case for competition appears the logically superior one. However, doubts and queries about the operation of the system have nevertheless been expressed. Critics have especially emphasized potential problems concerning the stability and emergence of efficient supplies of currency when competition is allowed to regulate its production.

### *Is a Free-Market Monetary System Stable?*

The issue of stability centers on the question of the controllability of a currency's value under a "perfectly" competitive scheme. This is sometimes framed, inversely, as the problem of

"infinite" levels of money prices presumably resulting from a laissez-faire regime. Boris Pesek, for example, expresses the belief that in the long run a competitive paper currency system would generate a situation in which "money is so 'abundant' as to sell for a zero price and be a free good," producing a "regression into full-time barter since free money is worthless money, incapable of performing its task of facilitating exchange of goods among persons."<sup>74</sup> Benjamin Klein, as noted earlier, has demonstrated that such a result depends on improperly specified or protected property rights in the currency industry, and would emerge in *any* market in which brand names could be counterfeited. In such a market, producers and consumers lack a signaling mechanism by which to identify the outputs of different firms in the industry, so that a low-quality product cannot be identified and shunned in advance. Explains Klein:

It is true that if, for example, a new money producer could issue money that was indistinguishable from an established money, competition would lead to an overissue of the particular money and the destruction of its value. The new firm's increase in the supply of money would cause prices in terms of that money to rise and, if anticipated, leave real profit derived from the total production of the money unchanged. But there has been a distribution effect—a fall in the established firm's real wealth. The larger the new firm's money issue the greater its profit; therefore profit maximization implies that the new firm will make unlimited increases in the supply of the money, reducing the established firm's profit share close to zero (unless it too expands.)

If the established firm legally possesses a trademark on its money, this "externality" of the new firm's production represents a violation of the established firm's property right and is called counterfeiting. Lack of enforcement of an individual's firm's property right to his particular name will permit unlimited competitive counterfeiting and lead to an infinite price level. This merely points up the difficulties in the usual specification of competitive conditions. If buyers are unable to distinguish between the products of competing firms in an industry, competition will lead each firm to reduce the quality of the product it sells since the costs of such an action will be borne mainly by the other firms in the industry . . . . [I]ndistinguishability of the output of competing firms will lead to product quality depreciation in any industry.<sup>75</sup>

Thus, in order to solve the paradox of infinite price levels, we need only introduce into a competitive currency model that was designed to prove the instability of free trade in money an assumption implicit in all standard analyses of competitive industry: the premise that products are distinguishable with respect to origin. (This is not inconsistent with another assumption of "perfect competition" models: that products are completely indistinguishable or identical with respect to their flow of services.) On making this assumption the proof is reversed, and we may deduce stability properties typically found in a perfectly competitive world. Criticisms of the stability properties of a free-market monetary system in this case point up a potential problem concerning the

appropriate legal structure necessary for a properly functioning competitive system, rather than a problem of the competitive market structure *itself*, given a well-defined system of property rights.

*Could Private Token Currencies Emerge? Would They?*

The emergence of a competitive token monetary system from the existing domestic government monopoly raises two questions. First, there is the issue of how in theory a system of multiple monies could emerge; and second, there is the question of whether in practice such an evolution should be expected to take place once the requisite property rights structure has been established for the industry.

Posing the first question, Henry Hazlitt asks:

(H)ow does a private issuer establish the value of his money unit in the first place? Why would anybody take it? Who would accept his certificates for their own goods and services? And at what rate? Against what would the private banker issue his money? With what would the would-be user buy it from him? Into what would the issuer keep it constantly convertible? These are essential questions.<sup>76</sup>

Indeed, new currencies would not appear or be accepted overnight. During the gradual process of establishing a private currency, the issued certificates would not immediately be greeted by money-users as currency. At the outset they would be supplied to the public in the form of money *substitutes*. These money substitutes would be supplied under an explicit contract guaranteeing the bearer some minimum rate of exchange between these certificates and one or more commodities or pre-existing currencies. Currency entrepreneurs would of course decide which commodities or monies to use in this process, and money-users would then choose from among the alternatives offered.<sup>77</sup>

Only later, after the issuing firm had fostered sufficient consumer confidence in its trademarked tokens by making the necessary investments in the firm's "brand-name capital,"<sup>78</sup> would the issued notes begin to take on a monetary life of their own. The point marking this transformation is reached when currency-users effectively acknowledge the new currency as "monetized" by no longer routinely demanding that it be converted into another more liquid asset. Instead transactors begin circulating the notes as an independent exchange medium in their daily business.

Empirical doubts about the second question—*whether* a competitive currency system would in fact spontaneously emerge under the right legal conditions—are almost without exception framed in terms of the economic concept of "transactions costs." They are presented on the basis of a number of confusions,

widespread within the economics profession, concerning the notions of "cost," "choice," and "competition." Such confusions are all too familiar to Austrian economists.

Arguments that deny the likely emergence of concurrent privately issued monies under *laissez faire* typically run as follows. People employ goods "having currency" for a variety of reasons, the most important among these being the purpose of transacting economic exchanges. In its capacity as a medium of exchange, a monetized commodity, due to its quality of being highly marketable, provides the transactor with a device which allows him to economize on the time and resources required to complete his desired set of exchanges. Thus far the argument is unobjectionable. Confusion enters in the form of a *non sequitur* when the argument leaps to the conclusion that, to the individual agent, "money is more useful the larger its transactions domain." On this basis Roland Vaubel argues that

Since the cost of using money falls as its domain expands, the quality (and, hence, the value) of the product money and, consequently, the marginal value productivity of the factors engaged in its production increase so that the money industry must be viewed as a (permanently) declining-cost industry.<sup>79</sup>

This argument leads Vaubel to conclude: "Ultimately, currency competition destroys itself because the use of money is subject to very sizeable economies of scale. The money-industry must be viewed as a 'natural monopoly,' which at some stage must be nationalized." He adds that since it is "undisputed that lines of production that are subject to permanently declining cost must at some stage be nationalized (or, in an international context, be 'unified'), the fact that currency competition will lead to currency union must be regarded as desirable."<sup>80</sup>

This argument labors under some rather common misconceptions. First, only individuals transact, and they do so only with one other individual or organization at a time, rather than with the *entire* economic order or "transactions domain." Further, there are likely to be many sectors of the monetized system with which these actors have little or no interest in dealing. These submarginal transactions areas vary from person to person. It is not at all obvious, then, that a money *will* be "more useful" to any given agent, the more universal or extensive the domain within which the money (or monies) he uses circulates. Some degree of specialization and heterogeneity in the currency industry's supply of services may in fact persist indefinitely because of persistence of differences in the needs and purposes of the various money-using members of a community.<sup>81</sup> In that case, several different issues may circulate side by side, each servicing the individuated demands of a separate subset or "neighborhood" of

the "global" transactions domain. And, of course these currency areas may overlap.

The exact configuration of the resulting monetary mosaic is unpredictable under a competitive monetary arrangement since each currency consumer's choice from among the array of currencies available to him is made according to purely subjective benefit-cost calculations. Accordingly, the aggregate impact of consumers' choices in determining a given currency's domain will be revealed only after the execution of the particular plans that are based upon these calculations. Since their requirements may, for example, be highly localized geographically, it seems unreasonable to conclude *a priori* that a system of several concurrently circulating monies is "likely to be purely transitory, and that the only lasting—and again desirable—result will be currency union."<sup>82</sup>

A second problem with the prediction of a "spontaneous monopolization" of the currency industry concerns the misconception of the competitive process that underlies this forecast. Surely, no one can resist reaching the conclusion that "competition destroys itself" in *any* industry in which marginal costs of production are continuously falling; no one, that is, who has adopted the entrepreneurially *static* notion of "perfect competition" as a benchmark. In that conceptual framework, the criterion of a "competitive" industry refers to a specific *magnitude* or *pattern* ("many" firms or price equal to marginal and average costs), rather than to the end-independent (and unceasing) *process* (rivalrous pursuit of profits) that characterizes the operation of the system. It naturally follows that any industry not obeying the perfectly competitive "pattern" must by definition exhibit "monopolistic tendencies."<sup>83</sup>

Once we recognize, however, that real-life competition is a dynamic and unending discovery process, we no longer can meaningfully judge an actual industry's competitiveness by comparing it with some final static state of "optimality," "perfection," or "equilibrium." So long as the necessary legal framework is in force, the competitive process *is* at work whether one firm *or* many firms persist. In Brian Loasby's words: "[T]he critical question is, not what should the pattern of resource allocation *look* like, but *how* is it to be achieved; and the perfectly competitive model, which has defined the terms of the argument, provides no recipe for achieving anything. Actual competition is a process, not a state; and perfect competition can exist only as the description of a state."<sup>84</sup>

Vaubel goes on to offer one more criticism of the efficiency of competing currencies. He argues that because "a good like money[s]. . . precise purpose is to reduce transaction cost, infor-

mation cost and risk (as compared with barter), a diverse plethora of private issuers in the industry is likely to be “particularly inconvenient” due to the “diseconomies of small scale.” He further argues that these effects “do not disappear if all banks of issue are led or forced to denominate their monies in the same standard of value.”<sup>85</sup> The issue of whether several concurrently circulating exchange media would present an inconvenience to currency-users depends, again, on the individual users’ subjective evaluations of the benefits and costs involved. The outcome cannot be conclusively determined *a priori* by the theorist. What is more, it is of interest to note that economic historian Hugh Rockoff has offered evidence which suggests by analogy that the benefits of a multi-issuer system may in fact *outweigh* the possible inconvenience in the estimations of consumers:

[I]t seems unlikely that the heterogeneous nature of the currency (of the nineteenth century) was a major brake on economic growth, for in many crucial respects the system was little different from that which prevails today. Locally we use demand deposits. But these are not generally acceptable as a means of payment. Each time we wish to make a purchase by check from a businessman we force him to make some judgement about the quality of the money we are offering. Instead of having to worry about different kinds of bank notes a merchant today must worry about different kinds of deposits which could be as numerous as his customers. Counterfeiting currency is now rare, but forged checks and insufficient balances are a constant irritation. Yet no one today would argue that the heterogeneity of our deposit money is a serious impediment to the growth of national income . . . [T]he inefficiency of a heterogeneous currency should not be exaggerated.<sup>86</sup>

### *Skepticism From Gold Standard Advocates*

It should be mentioned that a few advocates of the gold standard have questioned the feasibility of privately circulated issues of explicitly “token” form.<sup>87</sup> Their criticisms are clearly directed not against market-oriented monetary reform *per se* (as the gold standard they advocate is itself a market-controlled monetary system), but rather against a system of irredeemable and exclusively paper monies. According to these skeptics, the Hayekian paper regime could never exist. A purely fiduciary money is simply not possible in a world of free and rational agents; and it follows, they argue, that a system of competing paper issues is also impossible:

In a truly free society, . . . Professor Hayek and his bank would be allowed to issue paper certificates. So would we and our neighbors down the street. The real question is: Who would *accept* such certificates for their goods or services? Remember, they are not legal tender. Their value could not be insured . . . It is difficult to believe that sophisticated businessmen would long accept such paper certificates when, in a free society, they could ask for and receive gold or certificates redeemable in gold. . . .

Given the fact that few people now alive have ever known sound money and given the general ignorance of sound monetary theory, it is

possible that some established banks might find some who would accept their privately issued paper certificates. But, as Hans Christian Andersen tells the story of the illusion of "The Emperor's Clothes," sooner or later some innocent bystander would point out that such paper certificates are not the most marketable commodity in a free society and hence not "money."<sup>88</sup>

It is surprising how many basic confusions concerning the theories of subjective valuation, money, and the spontaneous order have been included in such a short passage. The implication that an established token issue's acceptability is necessarily dependent upon its possessing a governmentally sanctioned "legal tender" status ("Remember they are not legal tender") is false. In contrast to these would-be Misesian writers, Mises himself notes:

The law may declare anything it likes to be a medium of payment . . . But bestowing the property of legal tender on a thing does not suffice to make it money in the economic sense. Goods can become common media of exchange only through the practice of those who take part in commercial transactions. . . . Quite possibly, commerce may take into use those things to which the State has ascribed the power of payment; but it need not do so. It may, if it likes, reject them.<sup>89</sup>

If these writers mean to suggest that token money is exclusively a "creature of the State," perhaps they should say so directly.

The bald assertion that a newly issued private money's value "could not be insured" is also incorrect. More than one author has explained how and why such "value insurance" for new monies might hypothetically be made available to interested-but-wary potential customers.<sup>90</sup> What is worse, the assertion represents a disconcertingly unannounced jump in logic. It leaps from a general and objective analytical discussion of the issues to a highly specific and essentially entrepreneurial judgment concerning the dimensions in which the market for insurance services could or could not operate in the future. An economist oversteps his bounds in going beyond purely scientific explanations of the operations of the competitive process in the currency industry into the realm of concrete predictions concerning the industry's future organization ("supply-side") and qualitative ("demand-side") features. Such prediction is the concern of entrepreneurs. In these instances, criticism seems to reveal a basic misunderstanding of the literature concerning the Hayekian private paper money system in particular, and of the theory of the spontaneous order as a fluid discovery process in general.

The fact of the matter is that individuals do transact with and are willing to hold merely "token" currencies.<sup>91</sup> Even more generally, we may note that presumably rational, valuing agents, when situated within the context of a social system, continuously engage in various "customary" activities or follow established "norms" or procedures that do not yield obvious and direct benefits

to them. These modes of behavior have evolved to facilitate social intercourse, though frequently those practicing them may be incapable of articulating or rationalizing those functions explicitly.<sup>92</sup> The question is, should we deny or ignore the actual existence of certain forms of money or various other "products of human action but not of human design" simply because their acceptability seems "difficult to believe"? Or should we recognize that such structures do indeed exist, although to date their occurrence remains to be satisfactorily explained? To the inquiring mind, the answer seems obvious.

Additional and more practical objections to a system of free-market paper monies have been developed in the literature.<sup>93</sup> A number of these have come (somewhat surprisingly) from the program's chief proponent, F. A. Hayek.<sup>94</sup>

#### *Rules and Commands: Their Confusion by the Constitutionalists*

Finally, one of the most important arguments against monetary competition is implicit in a leading defense of a constitutionally constrained monopoly. This argument, which has been frequently invoked by monetary constitutionalists of both the Monetarist and Public Choice camps, seems, again, to rest on some rather serious misconceptions: The use of money, it is argued, is directly analogous to the following of legal rules of conduct within a civilization. Further, both the law and money come under the category of highly social "multi-purpose instruments."<sup>95</sup> Since the extra-market constitutional mechanisms devised in the past appear to facilitate the successful functioning and development of the *legal* order, it seems naturally to follow that the creation of such a mechanism for the *monetary* order would serve to enhance *its* operation and progress as well. The creators and practitioners of law are continuously guided in their deliberations by a meta-legal framework of general principles that provides a point of reference for "producing" proper legislation. Similarly, might not the creators and practitioners (managers) of the currency system be disciplined in their day-to-day activities by a set of principles? A monetary constitution would thereby insure that the "proper" monetary services would be produced and made available to market participants.<sup>96</sup>

Two rather basic errors mar this argument. The first is that an analogy *per se* demonstrates nothing. It may indeed be true the use of currency in economic interactions has characteristics similar to those of the adherence to legal rules in social interactions. But it does not follow that it is therefore necessary for efficiency that the production of money be carried out within an institutional framework analogous to that created for the produc-

tion of laws—a closed, governmentally controlled, jurisdictional monopoly. If this conclusion really were thought to follow, moreover, it would prove too much. That is, it would be unclear why its proponents have not also endorsed the socialization of religion, say, or the development of a constitution mandating and defining an overall set of principles for the production and use of language in society. If the evolution of optimal “supplies” of languages and language areas is allowed to be determined by spontaneous order, why then should not optimal money supplies and currency areas be so determined as well?

The second and more serious problem with the above argument is that the specific analogy used is flawed. It overlooks a crucial difference between currency and rules: laws (written down explicitly or not) are *prerequisites* for market activity. Money, while it does facilitate such activity, is not a prerequisite. Money is a *good* with a distinct demand and supply. Being an economic commodity capable of providing specific services to its users, there is no apparent reason why its production cannot be regulated by the *same* rules which guide the creation of *all* goods—the body of laws protecting competitive activity.

When it is claimed that currency production must be supervised by its own “special” legal framework and protected from the competitive process by being manufactured only by government, whereas other goods may be produced competitively under the standard legal framework calling for free and equal exchange, a confusion between the notion of *abstract rules* and that of particular *commands* is apparent. Those advocating a monetary constitution propose *not* an abstract rule for the promotion of the general welfare of those who manage their affairs within the nexus of the monetized exchange system, but what is in essence a monetary *command*—a command being defined as a rule “for the performance of assigned, specific, tasks”—for centrally planned money production. They, in short, take a “constructivistic” approach to monetary matters.<sup>97</sup> Indeed, money and law are both “multi-purpose” tools facilitating social interchange. But whereas laws are procedural dictates, money is an economic good.

As Hayek has pointed out on numerous occasions,<sup>98</sup> what generalized “principles of justice” or “rules of just conduct” are intended to generate is not a command society (which *would* be the result if these “rules” were defined according to the end-specific criterion implied by the monetary constitutionalists), but rather a competitive society. The proper role of constitutional laws or principles is that of arbitrarily defining the set-up of the apparatus (government) by which the generalized rules of conduct of the liberal social order may be enforced. The French classical liberal Frederic Bastiat put the entire matter succinctly in *The*

*Law*: "liberty means competition."<sup>99</sup> And, as Girton and Roper state clearly with respect to the monetary system of an open society in particular: "Competition in money issue *provides* a rule *enforced by the market*, and a monetary standard that is attractive compared to current monopoly paper money standards."<sup>100</sup>

### *Monetary Constitutionalists as Entrepreneurs in Scientists' Clothing*

By denying currency the status of a privately producible "good" capable of being regulated by the pressures of market competition (and instead elevating it to the status of a supra-market social tool which needs by its very nature to be supplied by a non-market governmental agency), the monetary constitutionalists are in fact stepping out of realm of scientific conjecture and into the domain of entrepreneurial conjecture. In the case of each program for a monetary constitution or "rule," the author has tacitly adopted the approach of the hypothetical currency producer-entrepreneur seeking the best production method. But rather than admit this, and in the process acknowledge that the only objective test of the correctness of such conjectures is the profit-and-loss test of market competition, each author continues to use the rhetoric of scholarship in the development of a "scientific" argument for his own particular "brand" of currency and its production design. What we have here is a case of entrepreneurs in scientists' clothing.

## **IV. Conclusion: Competition as the Proper Response to Ignorance**

Economists have clearly articulated the need for reform of the existing monetary system. The available alternatives for change have in recent years also taken clear and unambiguous shape: *either* continued yet constrained monopoly *or* free-market competition in the supply of currency. The case for competition rather than constitutional restriction seems at present to be far stronger. The essence of the argument for free currency competition has perhaps been best expressed by Brian Loasby, who writes:

The argument for competition rests on the belief that people are likely to be wrong. . . . In the end, the case against an authoritarian system of resource allocation rests on the same principle as the case against an authoritarian structure in any discipline: part of the case . . . is that no person or body of persons is fit to be trusted with such power; the (other) part . . . is that no one person or group of persons can say for sure what new knowledge tomorrow will bring. Competition is a proper response to ignorance.<sup>101</sup> □

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## FOOTNOTES

1. [Carl] Menger, "On the Origin of Money," *Economic Journal* 2 (June 1892): 239–255. A modern version of Menger's theory has been developed by Robert A. Jones, "The Origin and Development of Media of Exchange," *Journal of Political Economy* 84 (Nov. 1976): 757–775.
2. Karl Brunner and Allan H. Meltzer, "The Uses of Money: Money in the Theory of an Exchange Economy," *American Economic Review* 61 (Sept. 1973): 799.
3. Brian Loasby, *Choice, Complexity and Ignorance* (New York, Cambridge: Cambridge University Press, 1976) p. 165.
4. In addition to those already cited, see W. W. Carlile, *The Evolution of Modern Money* (London: Macmillan, 1901); W. Stanley Jevons, *Money and the Mechanism of Exchange* (London: Kegan Paul, 1905); W. T. Newlyn, *The Theory of Money* (London: Oxford University Press, 1971); Boris P. Peseck and Thomas R. Saving, *Money, Wealth and Economic Theory* (New York: Macmillan, 1970); C. A. E. Goodhart, "The Role, Functions, and Definition of Money," in G. C. Harcourt, ed., *The Microfoundations of Macroeconomics* (Boulder, Co.: Westview Press, 1977), pp. 205–277; Leland Yeager, "Essential Properties of the Medium of Exchange," *Kyklos* 21 (Jan. 1968): 45–68; William H. Hutt, "The Nature of Money," *South African Journal of Economics* 20 (March 1952): 50–64; Hutt, "The Yield from Money Held," in Mary Sennholz, ed., *The Economics of Free Enterprise* (Princeton: Van Nostrand, 1956): pp. 196–216; Hutt, "The Notion of the Volume of Money," *South African Journal of Economics* 20 (Sept. 1952): 231–241; Hutt, "The Notion of Money of Constant Value," *South African Journal of Economics* (Sept.–Dec. 1953); Hutt, "The Concept of Idle Money," in *The Theory of Idle Resources* (Indianapolis: Liberty Press, 1977); Murray N. Rothbard, "The Austrian Theory of Money," in Edwin G. Dolan, editor, *The Foundations of Modern Austrian Economics* (Kansas City: Sheed and Ward, 1976), pp. 160–184; Joseph M. Ostroy and Ross M. Starr, "Money and the Decentralization of Exchange," *Econometrica* 42 (Nov. 1974): 1093–1113; Morris Perlman, "The Roles of Money in an Economy and the Optimum Quantity of Money," *Economica* 38 (Aug. 1971): 233–252; Jack Hirschleifer, "Exchange Theory: The Missing Chapter," *Western Economic Journal (Economic Inquiry)* (June 1973): 129–146; Robert Clower, "A Reconsideration of the Microfoundations of Monetary Theory," *Western Economic Journal (Economic Inquiry)* 6 (Dec. 1967): 1–8; Harold Demsetz, "The Cost of Transacting," *Quarterly Journal of Economics* 82 (Feb. 1968): 33–53; and R. A. Radford, "Money in a Prisoner-of-War Camp," in Jonas Prager, ed., *Monetary Economics: Controversies in Theory and Policy* (New York: Random House, 1971), pp. 6–8.
5. In the case of the U.S. Federal Reserve System, this is only a shorthand way of describing the usual process of monetary expansion. More precisely, the Fed injects new bank reserves into the system, enabling commercial banks to issue new money.
6. An especially important transfer of the first type, namely to capitalist investors from other income groups, occurs when new money is injected as loanable funds made available by the central bank. This transfer, known as "forced savings" because it involuntarily restricts the availability of resources for consumption, plays an important role in the Austrian theory of the trade cycle. See F. A. Hayek, "A Note on the Development of the Doctrine of 'Forced Saving'," in *Profits, Interest and Investment* (New York: Augustus M. Kelley, 1975), pp. 183–197; and *Prices and Production* (New York: Augustus M. Kelley, 1967), pp. 18–22, 85–91.
7. See John Culbertson, *Macroeconomic Theory and Stabilization Policy* (New York: McGraw-Hill, 1968); Nancy Smith Barrett, *The Theory of Macroeconomic Policy* (Englewood Cliffs, NJ: Prentice Hall, 1975); Michael R. Darby, *Macroeconomics* (New York: McGraw-Hill, 1976); and Rudiger Dornbusch and Stanley Fischer, *Macroeconomics* (New York: McGraw-Hill, 1978). Also relevant are E. S. Phelps et al., *Microeconomic Foundations of Employment and Inflation Theory* (New York: W. W. Norton, 1970); and Don Patinkin, *Money, Interest, and Prices* (New York:

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8. See also Milton Friedman, "Government Revenue from Inflation," *Journal of Political Economy* 79 (July–Aug., 1971): 846–856; Eamonn Butler, "How Government Profits from Inflation," *Policy Review* 6 (Fall 1978): 73–76; Leonardo Auernheimer, "The Honest Government's Guide to the Revenue from the Creation of Money," *Journal of Political Economy* 82 (May–June 1974): 598–606; Martin Bailey, "The Welfare Cost of Inflationary Finance," *Journal of Political Economy* 64 (April 1956): 93–110; and Michael Mussa, "The Welfare Cost of Inflation and the Role of Money as a Unit of Account," *Journal of Money, Credit, and Banking* 9 (May 1977): 276–286.
  9. But for an alternative view—that of monetary statism—see G. F. Knapp, *The State Theory of Money* (London: Macmillan, 1924); and Abba P. Lerner, "Money as a Creature of the State," *American Economic Review* 37 (May 1947 supplement): 312–317.
  10. S. Herbert Frankel, *Money: Two Philosophies* (England: Basil Blackwell, 1977), p. 86. See also this book's recent sequel, *Money and Liberty* (Washington: American Enterprise Institute, 1980).
  11. On the importance of such institutions see F. A. Hayek, *Law, Legislation and Liberty*, vol. II (Chicago: University of Chicago Press, 1978), ch. 7.
  12. These include William T. Baxter, Solomon Fabricant, et al., *Economic Calculation Under Inflation* (Indianapolis: Liberty Press, 1976); Ludwig von Mises, *Human Action: A Treatise on Economics* (Chicago: Henry Regnery, 1966), pp. 550–565; Axel Leijonhufvud, "Costs and Consequences of Inflation," in *Information and Coordination* (New York: Oxford University Press, 1981), pp. 227–269; William D. Bradford, "Monetary Position, Unanticipated Inflation, and Changes in the Value of the Firm," *Quarterly Review of Economics and Business* 16 (Winter 1976): 47–53; and Benjamin Klein, "The Social Costs of the Recent Inflation: The Mirage of Steady 'Anticipated' Inflation," in Karl Brunner and Allan H. Meltzer, eds., *Institutional Arrangements and the Inflation Problem* (New York: North Holland, 1976), pp. 185–212.
  13. See Constantino Bresciani-Turroni, *The Economics of Inflation* (London: George Allen and Unwin, 1937); C. A. Phillips, T. F. McManus and R. W. Nelson, *Banking and the Business Cycle* (New York: Arno Press, 1972); Ludwig von Mises, *On the Manipulation of Money and Credit* (Dobbs Ferry, NY: Free Market Books, 1978); F. A. Hayek, *Monetary Theory and the Trade Cycle* (Clifton, NJ: Augustus M. Kelley, 1975); Hayek, *Full Employment at Any Price?* (London: Institute of Economic Affairs, 1975); Hayek, "Full Employment, Planning and Inflation," in *Studies in Philosophy, Politics and Economics* (New York: Simon and Schuster, 1967), pp. 270–279; Milton Friedman, "The Effects of a Full-Employment Policy on Economic Stability," in *Essays in Positive Economics* (Chicago: University of Chicago Press 1966), pp. 117–132; Otto Eckstein, "Instability in the Private and Public Sectors," *Swedish Journal of Economics* 75 (March 1973): 19–26; and Benjamin Klein, "Our New Monetary Standard: The Measurement and Effects of Price Uncertainty, 1880–1973," *Economic Inquiry* 13 (Dec. 1973): 461–484.
  14. Axel Leijonhufvud, *Information and Coordination*, p. 259. Italics in the original deleted.
  15. The long-run Phillips Curve, to use that manner of speaking, is said to be positively sloped rather than negatively sloped. See Hayek, *Full Employment at Any Price?*; Milton Friedman, "Nobel Lecture: Inflation and Unemployment," *Journal of Political Economy* 85 (June 1977): 451–472; Robert E. Lucas, "Some International Evidence on Output-Inflation Tradeoffs," in *Studies in Business Cycle Theory*, pp. 131–145. On the Rational Expectations theorists as "neo-Austrians," see David Laidler, "Monetarism: An Interpretation and an Assessment," *Economic Journal* 91 (March 1981): 1–28.
  16. For evidence and discussion supportive of reliance upon "discretionary" money and credit management for the achievement of policy objectives, see for example, Phillip J. Cooper and Stanley Fischer, "Simulations of Monetary Rules in the FRB-MIT-Penn Model," *Journal of Money, Credit, and Banking* 4 (May 1972): 384–396; C. R. Whittlesey, "Rules, Discretion, and Central Bankers," in C. R. Whittlesey and J. S. G. Wilson, editors, *Essays in Money and Banking in Honor of R. S. Sayers* (Oxford: Clarendon Press, 1968), pp. 252–265; L. R. McPheters and M. B. Redman, "Rule, Semirule, and Discretion During Two Decades of Monetary Policy," *Quarterly Review of Economics and Business* 15 (Spring 1975): 53–64; D. A. Peel,

"Some Implications of Alternative Monetary Rules," *Indian Economic Journal* 27 (July–Sept. 1979): 81–94; Daniel Ahearn, "Automatic Increases in the Money Supply: Some Problems," in Jonas Prager, ed., *Monetary Economics: Controversies in Theory and Policy*, pp. 352–355; and Franco Modigliani, "Some Empirical Tests of Monetary Management and of Rules Versus Discretion," *Journal of Political Economy* 72 (June 1964): 211–245.

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17. Hans F. Sennholz, *Inflation or Gold Standard*, p. 57.
18. See Murray N. Rothbard, "The Case for a 100 Percent Gold Dollar," in: Leland B. Yeager, editor, *In Search of a Monetary Constitution* (Cambridge: Harvard University Press, 1962), pp. 94–136; Rothbard, *What Has Government Done to Our Money?* (Novato, CA: Libertarian Publishers, 1978); Henry Hazlitt, *The Inflation Crisis and How to Resolve It* (New York: Arlington House, 1978); See also Joseph T. Salerno, "A Proposal for Monetary Reform: The 100% Gold Standard," *Policy Report* (July 1981): 6–11. For an analysis and defense of free banking on a specie standard see Lawrence H. White, "Free Banking as an Alternative Monetary System," in M. Bruce Johnson and Gerald P. O'Driscoll, Jr., eds., *Inflation or Deflation?* (Cambridge, MA: Ballinger Publishing Co., forthcoming).
19. See F. A. Hayek, "A Commodity Reserve Currency," in *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 92–106; Benjamin Graham, "The Commodity Reserve Currency Proposal Reconsidered," in Leland Yeager, ed., *In Search of a Monetary Constitution*; Milton Friedman, "Commodity Reserve Currency," in *Essays in Positive Economics*; and Robert E. Hall, "Explorations in the Gold Standard and Related Policies for Stabilizing the Dollar," in Hall, ed., *Inflation* (Cambridge, MA: National Bureau of Economic Research, forthcoming).

The interested reader will also want to peruse "A Proposal for Monetary Reform" (unpublished ms., Sept. 1980) by John F. O. Bilson, in which an "equity" reserve standard is proposed. Under Bilson's scheme, the Federal Reserve System is transformed into a "type of Mutual Fund" which maintains a monetary base incorporating reserves composed of a diversified portfolio of "internationally traded" financial assets.

20. Neil H. Jacoby, "The President, the Constitution, and the Economist in Economic Stabilization," *History of Political Economy* 3 (Fall 1971): 398.
21. Cited in Friedman, *A Program for Monetary Stability* p. 85. An earlier version of the Act prepared by the Senate Banking and Currency Committee did contain a clause specifically instructing the Fed to manage the currency system for the clear and unambiguous co-purpose of "accommodating the commerce of the country and promoting a stable price level." (Hearings before the Committee on Banking and Currency, U.S. Senate, 63rd Congress, 1st session on S. 2639, 1913, vol. 2, p. 1730,

- sec. 15 of the bill.) It was deleted from the bill while in committee because it was believed that such a provision was an unnecessary precaution. It appears that a genuine ignorance of the potential importance of such an explicit provision caused its removal from the Act. See Irving Fisher, *Stabilized Money: A History of its Movement* (London: George Allen and Unwin, 1935), pp. 148 ff.
22. For a detailed historical discussion see Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton: Princeton University Press, 1971), pp. 189 ff. See also Irving Fisher, *Stabilized Money*; and C. A. Phillips, T. F. McManus, and R. W. Nelson, *Banking and the Business Cycle*.
  23. James M. Buchanan and Richard E. Wagner, *Democracy in Deficit* (New York: Academic Press, 1977); James M. Buchanan, Richard E. Wagner, and John Burton. *The Consequences of Mr. Keynes* (London: Institute of Economic Affairs, 1978); F. A. Hayek, "The Campaign Against Keynesian Inflation" in *New Studies in Philosophy, Politics, Economics, and the History of Ideas* (Chicago: University of Chicago Press, 1978), pp. 191–231; and Murray N. Rothbard, *For a New Liberty* (New York: Collier Books, 1978), ch. 9.
  24. John M. Culbertson, *Macroeconomic Theory and Stabilization Policy*, p. 453.
  25. Milton Friedman, "Should There Be an Independent Monetary Authority?," in Leland B. Yeager, ed., *In Search of a Monetary Constitution*, pp. 224–225, 239, 236.
  26. Milton Friedman, *A Program for Monetary Stability*, p. 86.
  27. Friedman, *A Program for Monetary Stability*, p. 93. See also Friedman, "The Effects of a Full-Employment Policy on Economic Stability: A Formal Analysis"; and Phillip Cagan and Anna J. Schwartz, "How Feasible is a Flexible Monetary Policy?," in Richard Selden, ed., *Capitalism and Freedom—Problems and Prospects* (Charlottesville: University Press of Virginia, 1975), pp. 262–310.
  28. See H. Geoffrey Brennan and James M. Buchanan, *Monopoly in Money and Inflation: The Case for a Constitution to Discipline Government* (London: Institute of Economic Affairs, 1981); Brennan and Buchanan, "Money Creation and Taxation," in *The Power to Tax: Analytical Foundations of a Fiscal Constitution* (New York: Cambridge University Press, 1980), pp. 109–134; Richard E. Wagner, "Economic Manipulation for Political Profit: Macroeconomic Consequences and Constitutional Implications," *Kyklos* 30 (1977): 395–410; and Keith Acheson and John F. Chant, "Bureaucratic Theory and Choice of Central Bank Goals," *Journal of Money, Credit, and Banking* 5 (May 1973): 637–655.
  29. Brennan and Buchanan, *Monopoly in Money and Inflation*, p. 23.
  30. Richard E. Wagner, "Politics, Monetary Control, and Economic Performance: A Comment," Mario J. Rizzo, ed., *Time, Uncertainty, and Disequilibrium* (Lexington, MA: D. C. Heath, 1979), pp. 178, 180.
  31. Gordon Tullock, "Competing Monies," *Journal of Money, Credit, and Banking* 7 (November 1975), pp. 496–497.
  32. John M. Culbertson, *Macroeconomic Theory and Stabilization Policy*, p. 148.
  33. Wagner, "Politics, Monetary Control, and Economic Performance," p. 179.
  34. Milton Friedman, *A Program for Monetary Stability*, p. 19.
  35. Milton Friedman, "The Optimum Quantity of Money," in *The Optimum Quantity of Money and Other Essays* (Chicago: Aldine Publishing Co., 1970), p. 34.
  36. In addition to Friedman's above-cited works see Milton Friedman, *Monetary Correction* (London: Institute of Economic Affairs, 1974), and Friedman, "A Monetary and Fiscal Framework for Economic Stability," in *Essays in Positive Economics*, pp. 133–156. Also see Richard T. Selden, "Stable Monetary Growth," in Leland B. Yeager, ed., *In Search of a Monetary Constitution*.
  37. E. S. Shaw, "Monetary Stability in a Growing Economy," in Moses Abramovitz, ed., *The Allocation of Economic Resources* (Stanford: Stanford University Press, 1959).
  38. Martin Bronfenbrenner, "Statistical Tests of Rival Monetary Rules," pp. 1–2; "Statistical Tests of Rival Monetary Rules: Quarterly Data Supplement," pp. 624–625.
  39. Clark Warburton, "Rules and Implements for Monetary Policy," *Journal of Finance* 8 (March 1953): 8; John M. Culbertson, *Macroeconomic Theory and Stabilization Policy*, p. 432.
  40. Henry C. Simons, "Rules Versus Authorities in Monetary Policy," pp. 164, 169; Willford King, "Sound Money—Why Needed and How Obtained," in Leland B. Yeager, ed., *In Search of a Monetary Constitution*, pp. 315–316.
  41. Jacob Viner, "The Necessary and the Desirable Range of Discretion to be Allowed to a Monetary Authority," in Leland B. Yeager, ed., *In Search of a Monetary Constitution*, pp. 244–274; Henry Simons, "Rules Versus Authorities in Monetary Policy"; Clark Warburton, "Rules and Implements for Monetary Policy"; William H. Hutt,

- Keynesianism—Retrospect and Prospect: A Critical Restatement of Basic Economic Principles* (Chicago: Henry Regnery, 1963), pp. 100–101; and Hutt, *A Rehabilitation of Say's Law* (Athens, OH: Ohio University Press, 1974), pp. 61–62. For Friedman's case against a fixed price-level rule, see his "The Role of Monetary Policy," *American Economic Review* 58 (March 1968): 1–17.
42. James M. Buchanan, "Predictability: The Criterion of Monetary Constitutions" in Leland B. Yeager, ed., *In Search of a Monetary Constitution*, pp. 155–183.
  43. Friedman, "Should There Be an Independent Monetary Authority?," p. 243. Emphasis added.
  44. Simons, "Rules Versus Authorities in Monetary Policy," pp. 175–176. This article first appeared in 1936.
  45. Friedman, "A Monetary and Fiscal Framework for Economic Stability," p. 135; "Should There Be an Independent Monetary Authority?," pp. 233–234; *A Program for Monetary Stability*, p. 99.
  46. Hutt, *Keynesianism, Retrospect and Prospect*, p. 100.
  47. John M. Culbertson, *Macroeconomic Theory and Stabilization Policy*, p. 423.
  48. F. A. Hayek, "Toward a Free Market Monetary System," *Journal of Libertarian Studies* 3 (Spring 1979): 1.
  49. Hayek, *Choice in Currency: A Way to Stop Inflation* (London: Institute of Economic Affairs, 1976), p. 16.
  50. Hayek, "Toward a Free Market Monetary System," pp. 2, 5.
  51. Hayek, "Toward a Free Market Monetary System," pp. 7–5.
  52. For secondary accounts see Vera C. Smith, *The Rationale of Central Banking* (London: P. S. King, 1936), chs. 6–10; Lawrence H. White, "Free Banking in Britain: Theory, Experience, and Debate" (Ph.D. dissertation, UCLA, 1982), chs. 2–3; and Philippe Nataf, "Free Banking: A Workable System," paper presented at the 10th annual conference of the Committee for Monetary Research and Education, Harriman, NY, 14 March 1982.
  53. Adam Smith, *An Inquiry Into the Nature and Causes of the Wealth of Nations*, Campbell-Skinner-Todd edition. (Oxford: Oxford University Press, 1976), I, pp. 320–321.
  54. Smith, *Wealth of Nations*, I, pp. 321, 329. Smith added the two qualifications that issuers be restricted from issuing (1) notes below some minimum denomination and (2) notes not unconditionally payable on demand. Both restrictions had been imposed on the Scottish banks in 1765.
  55. John Stuart Mill, *Principles of Political Economy* (London: John W. Parker, 1848), p. 675. Mill believed in having a non-market authority act as a central holder of bank reserves.
  56. Herbert Spencer, *Social Statics* (New York: D. Appleton and Co., 1881), pp. 434, 436. Spencer placed no qualifications on his support for free banking.
  57. William P. Gramm, "Laissez-Faire and the Optimum Quantity of Money," *Economic Inquiry* 12 (March 1974): 125–133.
  58. Harry G. Johnson, "Equilibrium Under Fixed Exchanges," *American Economic Review* 53 (May 1963): 113; Paul A. Samuelson, "What Classical and Neoclassical Monetary Theory Really Was," *Canadian Journal of Economics* 1 (Feb. 1968): 9–10; Boris P. Peseck and Thomas R. Saving, *Money, Wealth and Economic Theory* (New York: Macmillan, 1970), pp. 69 ff.
  59. Earl A. Thompson, "The Theory of Money and Income Consistent With Orthodox Value Theory," in P. A. Samuelson and G. Harwich, eds., *Trade, Stability, and Macroeconomics: Essays in Honor of Lloyd Meltzer* (New York: Academic Press, 1974), pp. 427–453. On Say's Law see William H. Hutt, *A Rehabilitation of Say's Law*; and Axel Leijonhufvud, *Information and Coordination*, pp. 79–101.
  60. Benjamin Klein, "The Competitive Supply of Money," *Journal of Money, Credit, and Banking* 6 (Nov. 1974): 423–453.
  61. Benjamin Klein, "Competing Monies, European Monetary Union, and the Dollar," in M. Fratianni and T. Peeters, eds., *One Money for Europe* (London: Macmillan 1978); Klein, "Money, Wealth, and Seignorage," in Kenneth Boulding and Thomas Frederick Wilson, eds., *Redistribution Through the Financial System* (New York: Praeger, 1978).
  62. Gordon Tullock, "Competing Monies," *Journal of Money, Credit, and Banking* 7 (Nov. 1975): 491–498.
  63. Benjamin Klein, "Competing Monies: A Comment," *Journal of Money, Credit, and Banking* 8 (Nov. 1976): 513–519; Gordon Tullock, "Competing Monies: A Reply," *Journal of Money, Credit, and Banking* 8 (Nov. 1976): 521–525.
  64. F. A. Hayek, *Choice in Currency: A Way to Stop Inflation* (London: Institute of Economic Affairs, 1976), pp. 17–18. The pamphlet's text has subsequently been

- reprinted in Hayek, *New Studies in Philosophy, Politics, and the History of Ideas*, pp. 218–231.
65. Hayek, *Denationalisation of Money—The Argument Refined*, 2nd ed. (London: Institute of Economic Affairs, 1978).
  66. For example Henry Hazlitt, in *The Inflation Crisis, and How to Resolve It*, p. 184, mistakenly interprets Hayek as contemplating private monies each convertible into a basket of commodities. Hayek, *Denationalisation of Money*, pp. 106–107, clearly denies that convertibility would be necessary.
  67. Hayek, *Denationalisation of Money*, p. 98.
  68. Lance Girton and Don Roper, "Substitutable Monies and the Monetary Standard," in Michael P. Dooley, Herbert M. Kaufman, and Raymond E. Lombra, eds., *The Political Economy of Policy-Making* (Beverly Hills: Sage Publications, 1979), pp. 233–246. See also Girton and Roper, "Theory and Implications of Currency Substitution," *Journal of Money, Credit, and Banking* 13 (Feb. 1981): 12–30.
  69. Roland Vaubel, "Free Currency Competition," *Weltwirtschaftliches Archiv* 112 (1977): 435–459.
  70. Martin Bronfenbrenner, "The Currency-Choice Defense," *Challenge* (Jan.–Feb. 1980): 31–36; F. A. Hayek, "Toward a Free Market Monetary System"; Lawrence H. White, "Gold, Dollars, and Private Currencies," *Policy Report* (June 1981): 6–11; Peter Lewin, "The Denationalization of Money," unpublished ms. (June 1981).
  71. Outstanding among these are Gordon Tullock, "Paper Money—A Cycle in Cathay," *Economic History Review* 9 (August 1957): 393–407; Luigi Einaudi, "Medieval Practice of Managed Currency," in Arthur D. Gayer, ed., *The Lessons on Monetary Experience* (New York: Augustus M. Kelley, 1970), pp. 259–268; Roland Vaubel, "Currency Competition in Monetary History," paper presented at the Institutum Europaeum conference on European Monetary Union and Currency Competition (December 1980); Bray Hammond, *Banks and Politics in America from the Revolution to the Civil War* (Princeton: Princeton University Press, 1957); Richard H. Timberlake, "Denominational Factors in Nineteenth-Century Currency Experience," *Journal of Economic History* 34 (December 1974): 835–884; William Woolridge, "Every Man His Own Mintmaster," in *Uncle Sam, The Monopoly Man* (New Rochelle, NY: Arlington House, 1970), pp. 54–74; Hugh Rockoff, "The Free Banking Era: A Reexamination," *Journal of Money, Credit, and Banking* 6 (May 1974): 141–168; Yu Ching Jao, *Banking and Currency in Hong Kong* (London: Basingstoke, 1974); and Lawrence H. White, "Free Banking in Britain: Theory, Experience, and Debate," ch. 2.
  72. Hayek, *Denationalisation of Money*, p. 44.
  73. Vaubel, "Free Currency Competition," pp. 445–446.
  74. Boris Pesek, "[Optimal Monetary Growth:] Comment," *Journal of Political Economy* 76 (July–Aug. 1968): 889.
  75. Klein, "The Competitive Supply of Money," pp. 429–430.
  76. Henry Hazlitt, *The Inflation Crisis, and How to Resolve It*, p. 185.
  77. See Hayek, *Denationalisation of Money*, pp. 42 ff; and Girton and Roper, "Substitutable Monies and the Monetary Standard," pp. 238–239.
  78. See Klein, "The Competitive Supply of Money," pp. 432–438, for elaboration of the "brand-name capital" concept.
  79. Vaubel, "Free Currency Competition," pp. 453, 458.
  80. Vaubel, "Free Currency Competition," pp. 437, 458. For similar "natural monopoly" arguments see Harry G. Johnson, "Problems of Efficiency in Monetary Management," *Journal of Political Economy* 76 (Sept.–Oct. 1968): 971–990; Richard N. Cooper, "European Monetary Unification and Integration of the World Economy," in Lawrence B. Krause and Walter S. Salant, eds., *European Monetary Unification and Its Meaning for the United States* (Washington, 1973); C. P. Kindleberger, "The Benefits of International Money," *Journal of International Economics* 2 (Nov. 1972): 425–442; R. I. McKinnon, "Optimum Currency Areas," *American Economic Review* 53 (Sept. 1963): 717–724.
  81. Such heterogeneity within any given "industry" is inconsistent with models of "perfect competition." Compare Hayek, *Denationalisation of Money*, pp. 72 ff.
  82. Vaubel, "Free Currency Competition," p. 440.
  83. This is Vaubel's characterization of the currency industry: "Free Currency Competition," p. 458.
  84. Loasby, *Choice, Complexity and Ignorance*, pp. 189–190. On competition as a process see also F. A. Hayek, "The Meaning of Competition," in *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), pp. 92–106; Hayek, "Competition as a Discovery Procedure," in *New Studies*, pp. 179–190; and Israel

- Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973).
85. Vaubel, "Free Currency Competition," pp. 457–458.
  86. Hugh Rockoff, "The Free Banking Era: A Reexamination," *Journal of Money, Credit, and Banking* 6 (May 1974): 144–145.
  87. Bettina Greaves and Percy Greaves, "On Private Paper Money," in Ludwig von Mises, *On the Manipulation of Money and Credit*, pp. 275–279; Henry Hazlitt, *The Inflation Crisis*, ch. 24.
  88. Greaves and Greaves, "On Private Paper Money," pp. 278–279, emphasis added.
  89. Mises, *The Theory of Money and Credit*, p. 70, emphasis in the original. On legal tender see also Herbert Spencer, *Social Statics*, p. 339; Thomas H. Farrer, *Studies in Currency* (London: 1898), p. 399; C. P. Kindleberger, "The Benefits of International Money," p. 426; and especially Vaubel, "Free Currency Competition," p. 438.
  90. See F. A. Hayek, *Denationalisation of Money*, p. 42; Lance Gorton and Don Roper, "Substitutable Monies and the Monetary Standard," p. 238.
  91. See, for example, the discussions in Milton Friedman, "Should There Be an Independent Monetary Authority?," pp. 221 ff.; and Richard H. Timberlake, "The Significance of Unaccounted Currencies" unpublished ms. (1980), p. 17.
  92. See F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960); Hayek, *Law, Legislation and Liberty* (Chicago: University of Chicago Press, 1973–79); Alexander James Field, "On the Explanation of Rules Using Rational Choice Models," *Journal of Economic Issues* 13 (March 1979): 49–72; John Rawls, *A Theory of Justice* (Cambridge: Harvard University Press, 1971).
  93. Henry Hazlitt, in *The Inflation Crisis*, p. 185, for example, objects that "you cannot make a currency convertible into an abstraction" such as an index number. For fascinating historical evidence to the contrary see Luigi Einaudi, "The Medieval Practice of Managed Currency." See also Dennis W. Richardson, "The Emerging Era of Electronic Money: Some Implications for Monetary Policy," *Journal of Bank Research* 3 (Winter 1973): 261–264.
  94. Hayek, *Denationalisation of Money*, discusses such potential problems as "parasitic" currencies (pp. 60–62), as well as the problems of transition to multiple currencies (sec. XXII).
  95. See F. A. Hayek, *Law, Legislation and Liberty*, vol. I, for this concept. Other such social institutions include moral codes, language, writing, and the convention of market exchange itself.
  96. Milton Friedman, "Should There Be an Independent Monetary Authority?," p. 242; Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1965), pp. 39, 53; Friedman, *A Program for Monetary Stability*, pp. 7–8; James M. Buchanan, "Predictability: The Criterion of Monetary Policy," p. 192; James M. Buchanan and T. Nicholas Tideman, "Gold, Money and the Law," in Henry Manne and Roger Miller, eds., *Gold, Money and the Law* (Chicago: Aldine, 1975), pp. 42–43; and Henry Simons, "Rules Versus Authorities in Monetary Policy," p. 162.
  97. For this distinction between rules and commands see Hayek, *Law, Legislation and Liberty*, vol. I, pp. 48, 149 ff. On constructivism see ch. I of that volume.
  98. Hayek, *The Constitution of Liberty*; Hayek, *Law, Legislation and Liberty*; Hayek, "Economic Freedom and Representative Government" and "The Constitution of a Liberal State" in *New Studies*; Hayek, "Toward a Free Market Monetary System." See also Bruno Leoni, *Freedom and the Law* (Los Angeles: Nash Publishing, 1972).
  99. Frederic Bastiat, *The Law* (Irvington-on-Hudson, NY: Foundation for Economic Education, 1950), p. 60, emphasis added.
  100. Gorton and Roper, "Substitutable Monies and the Monetary Standard," p. 234.
  101. Loasby, *Choice, Complexity and Ignorance*, p. 192.

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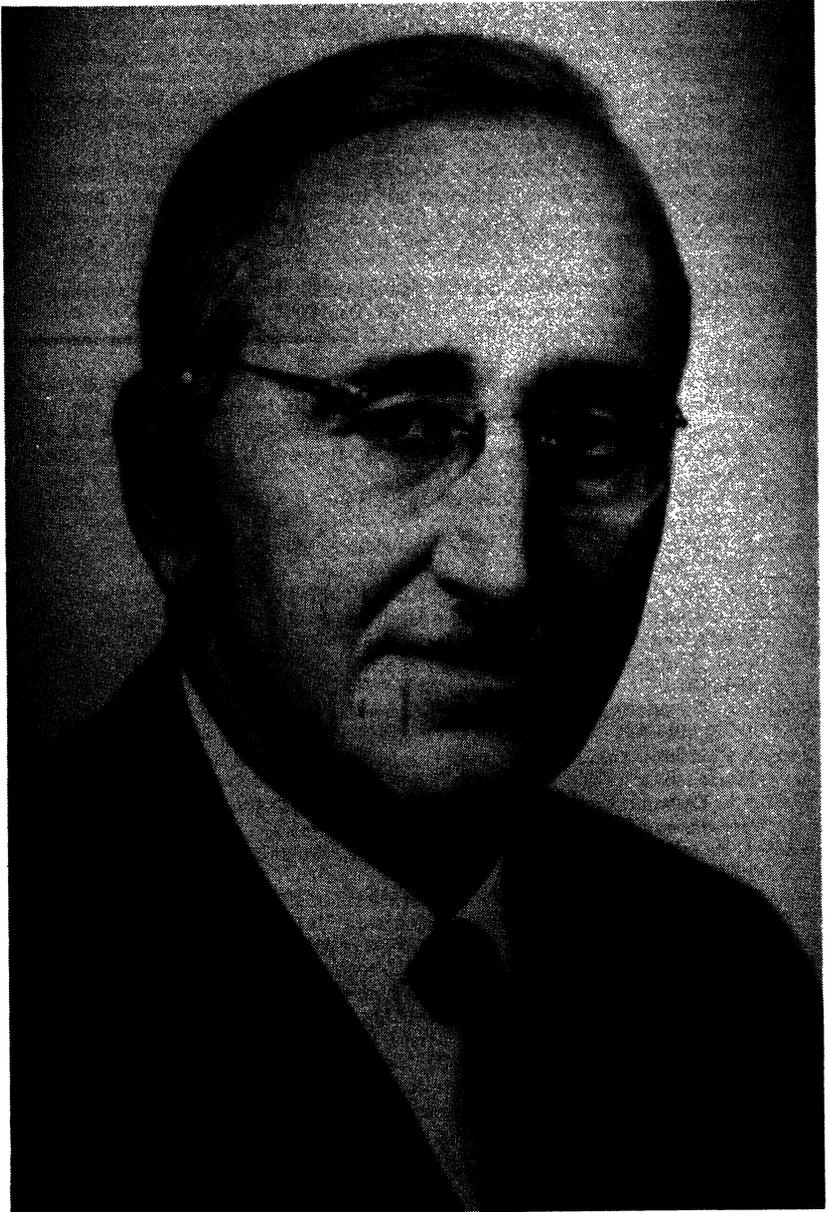
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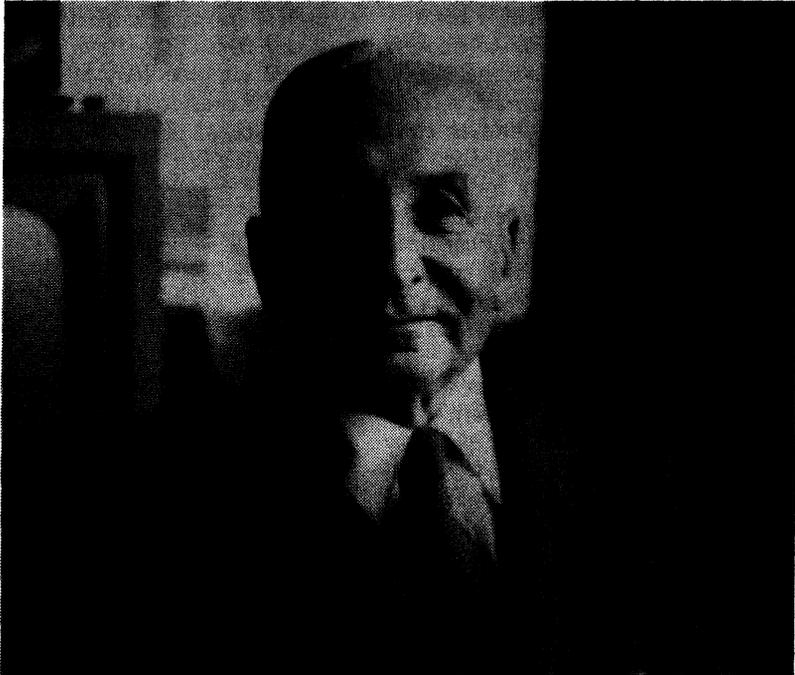
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# I

## Economics & Political Economy

In the debate over the proper monetary order for a free and prosperous society, as presented in Pamela Brown's lead essay, "Constitution or Competition? Alternative Views on Economic Reform," we discern the powerful, dogmatic role of ideology or what David Levy has called the "metatheoretical framework" in creating tragic economic results [see "Rational Choice and Morality: Economics and Classical Philosophy," *History of Political Economy* 14 (Spring 1982): 1-36]. If there is a divergence between one's monetary theory and reality or practical results, which is to change? Consistently, over the past half century, blind fidelity to the ideology of centralized control over money and credit and contempt for the spontaneous ordering of our economy through individuals' free choices has proven socially disastrous. Recessions, a debilitating inflation, and the current specter of the collapse of the world-wide monetary and economic order should provide sufficient "anomalies" to provoke us into questioning conventional wisdom on how to "run" an economy. *Literature of Liberty's* opening "Editorial" appropriately celebrates the uncompromising genius of Ludwig von Mises in challenging the counter-productive ideology of interventionism.



*Ludwig von Mises*

## Mises on Money & Inflation

Charles Hull Wolfe

"Ludwig von Mises: His Insight and Foresight on Money." Review essay of *On the Manipulation of Money and Credit* by Ludwig von Mises. Dobbs-Ferry, N.Y. Free Market Books, 1978. *The Intercollegiate Review* 16 (Fall 1980): 53-56.

**L**udwig von Mises (1881-1973), a leading spokesman of the "Austrian School" of economics, was well known for his keen economic insight and consistent logic. "As his fellow Austrian, Nobel prize economist F. A. Hayek, has written, even those who cannot follow his line of reasoning precisely usually find that later events prove him right. Thus, his analysis of money, inflation, and credit expansion becomes increasingly important the more people expect inflation to continue."

"Mises' *On the Manipulation of Money and Credit* contains new translations of several studies, not previously available in English, which Mises wrote between the two World Wars when he was an economic adviser to the Austrian government." The first of these, *Stabilization of the Monetary Unit—from The Viewpoint of Theory* (1923) predicts the runaway inflation that Germany was to experience later that year. The second study, *Monetary Stabilization and Cyclical Policy* (1928) analyzes schemes that resemble current plans to stabilize the purchasing power of money by indexation as a means to avert a depression. The third study, *The Causes of the Economic Crisis* (1931), "explodes the 'full employment' recommendation Keynes was to make five years later in his *General Theory* (1936)."

In our "age of inflation," Mises' analysis of the evils and consequences of governmental increases in the quantity of fiat money is all too relevant. Inflation produces higher money prices and wages and motivates people into panicky buying of homes, cars, and major appliances today on speculation or out of fear that prices will be even higher tomorrow. In

addition to shifts in prices and purchasing power, monetary expansion disturbs economic relationships. Inflation deceives businessmen by distorting economic calculations. It seduces businessmen into capital consumption and malinvestment until consumers demonstrate that they prefer buying lower order consumer goods rather than higher order capital goods and the products they provide.

Mises' volume incisively covers topics of crucial importance for our age: the German paper money inflation, credit expansion, the business cycle, deficit financing, trade balances, gold outflow, price indices, interest rates, and the creation of bank credit. Mises' analysis led him to advocate free banking and to warn against all attempts to manipulate interest rates and the quantity of money and credit: "The most important prerequisite of any cyclical policy, no matter how modest its goal may be, is to renounce every attempt to reduce the interest rate, by means of banking policy, below the rate which develops on the market."



# British Free Banking & Monetary Theory

Lawrence Henry White  
University of California, Los Angeles

"Free Banking in Britain: Theory, Experience, and Debate, 1800–1845." Ph.D. thesis; University of California, Los Angeles, 1982.

**F**ree banking—the system under which the paper currency of an area is issued by unregulated and competitive private banks on the basis of convertibility into standard coin—was widely advocated in the nineteenth century. White's dissertation studies the question of free banking as it confronted policy makers and economic writers in Britain in the first half of the nineteenth century. The study intertwines monetary theory, economic history, and the history of economic doctrine.

Chapter 1 undertakes to build a theory of free banking as a framework for the historical and doctrine-historical discussions of later chapters. The author models the individual bank of issue as a profit-maximizing firm and finds that the desired banknote circulation of the bank is limited by cost considerations. He next models the system as a whole, viewing it as a small open economy on an international specie standard, and finds its nominal magnitudes determinate. He then examines the equilibrating mechanisms which restrain banks from over-issuing by bringing about a "reflux" of excess notes. Reflux occurs as holders of excess notes re-establish their asset-holding preferences. Commonly the route of reflux passes through a note-exchange system, an inter-bank clearing mechanism whose origins are explained in an invisible-hand fashion.

Chapter 2 examines the record of free banking in Scotland, the world's clearest-cut example of free banking in practice. The author traces the evolution of the Scottish banking industry, emphasizing competitive entry and innovation. He then contrasts the arrangement, legal framework, and macroeconomic record of Scottish banking in its heyday with those of contemporary English banking, and finds the Scottish system superior.

The third chapter shows that the question of free banking versus central banking as the remedy for business cycles was a focal point of British monetary policy debates between 1820 and 1845. He revises the standard "Currency School-Banking School" picture of these debates by identifying the Free Banking School as an important third body of monetary thought. He traces the debates chronologically. Adam Smith and then the Bullionist controversy of 1800–1820 are treated as precursors. He next examines the free banking controversy of 1820–1845 in detail, placing the major contributors and their contributions against two sets of background events, the era's successive business cycles and its Acts of banking legislation.

Chapter 4 deals issue-by-issue with the major analytical differences dividing the Currency, Banking, and Free Banking School theorists. The issues treated are: (1) free trade in the production of currency; (2) over-issues under free banking and under central banking; (3) the origin and transmission of business cycles; (4) the "currency principle," the monetary rule proposed by the Currency School; (5) "banking principles," among which the author distinguishes the real bills doctrine, the needs of trade doctrine, and the "law of the reflux"; and (6) spontaneous (undesigned) order versus constructed order in monetary systems. In general the positions of the Free Banking School on these issues are found to have the greatest cogency.

The final chapter argues the relevance of free banking to contemporary discussion—particularly Hayek's call for "denationalization of money"—of alternative monetary institutions. White pictures free banking as a means of escaping the problem that a government monetary authority must be

dangerously flexible or dangerously inflexible. Free banking dispenses with government authority over money, and allows an orderly yet unmanipulated monetary system. Its use of precious metals as a monetary base is not ineffi-

cient when consumers prefer specie-based currency for its greater trustworthiness. A free market in currency is the only means of discovering the monetary system most preferred by consumers.

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## Smith as a Monetary Economist

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**David Laidler**

University of Western Ontario

"Adam Smith as a Monetary Economist." *The Canadian Journal of Economics* 14 (May 1981): 185-200.

**P**rofessor Laidler's main purpose is to argue that Adam Smith was a much better monetary economist than he is usually given credit for. The author argues that Smith believed the general price level to be determined by the cost of production of gold relative to that of goods, and that so long as bank money was convertible into specie, the general price level would therefore not vary.

Smith's analysis of the influence of the creation of bank money on the balance of payments must be viewed against the background of this theory of the general price level, as must his adherence to the Real Bills Doctrine. Finally, Smith's analysis of the replacement of specie with paper money makes his banking theory an integral part of his theory of economic growth.

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## Monetarism & Economic Ideology

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**Grahame Thompson**

"Monetarism and Economic Ideology." *Economy and Society* 10 (February 1981): 27-71.

**T**he author presents a socialist economic and political 'critique of ideology' directed against the current 'monetarism' espoused by the government of Great Britain. Specifically, Thompson looks at the economics of 'monetarism' as presented in two recent booklets: Tim Congdon's *Monetarism: An Essay in Definition* produced by Sir Keith Joseph's Centre for Policy Studies, and Bryan Gould's (*et al.*) *The Politics of Monetarism*, a Fabian Society Tract. In addition, Thompson comments on a recent document issued jointly by the Treasury and the Bank of England which is concerned with the issue of money

supply control: Cmnd. 7858, *Monetary Control* published by HMSO and known as the *Green Paper*.

After a discussion of the conceptualization of money and the way it functions, the author highlights the mechanisms by which 'monetarism' analyzes the relationship between the money supply and price formation. Borrowing from Tim Congdon's "fundamental precepts" of monetarist theory, Thompson lists three items on which, he claims, monetarists would agree:

(a) That 'money matters' and in particular that it is the quantity of money (or

stock of money) that determines prices. This is usually discussed in terms of the 'quantity equation':  $MV = PQ$  where  $M$  equals the stock of money,  $V$  is its velocity of circulation,  $P$  is the general price level, and  $Q$  the quantity of goods and services available (output in the period). Accepting that  $V$  and  $Q$  are constant for a moment,  $M$  determines  $P$  in simple terms.

(b) A 'belief in markets.' The idea here is that markets work; they clear in the 'long-run' so that the private sector is inherently stable. This relies upon an appeal to 'natural forces' that are supposed to be at work in the economy.

(c) That there is a stable relationship between the demand for money and money national income. While it is argued that there is such a stable relationship on the 'demand side,' the supply of money fluctuates widely (because of the government's need to finance itself under differing economic constraints) and this 'disturbs' the natural rhythms of the private sector. Thus, it is precisely government activity in this sense that sets up the disturbances in the economy, which themselves call forth the need for attempts at demand managed stabilization policies. Therefore 'stop-go' and the

government intervention that it implies is a product of government itself.

Thompson criticizes, from a socialist economic position, the inadequacy of the monetarist definition of the relationship between the money supply and price formation. The monetarist analyses of this relationship are inadequate largely because they are couched at an aggregative macro-level. A reformulation is suggested based upon the necessity to define the economic agents in the economy whose practices and processes provide the basis for the price formation and money-supply generation.

The concept of a 'money-supply' is raised and the difficulties of defining and controlling this in a developed financial system are discussed. "The attempt to control the money supply by Monetarist methods has so far been a failure. The financial system has gone on creating credit largely independently of Treasury and Bank of England policy. This focuses the main political point within this struggle—something which Congdon, Gould *et al.* and the *Green Paper* fail to appreciate—that the struggle is over which agents should have the monopoly of control over the creation of credit and money within the economy."

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## *Political Economy & Economic Science*

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**Lionel Robbins**

London School of Economics

"Economics and Political Economy," Richard T. Ely  
Lecture. *The American Economic Review* 71 (May  
1981): 1-10.

**F**ollowing David Hume's *Treatise of Human Nature* and Carl Menger's *Grundsätze*, Professor Robbins first defines the subject matter of Economic Science as the study of human behavior conditioned by scarcity. As such Economic Science conceives of scarcity as the relationship between objectives, either personal or collective, and the means of satisfying them. The limitation of goods confronted with conceivable demand is

the necessary condition of the activity of human economizing.

As regards the status of economics as a science, Robbins sees no reason to deny its susceptibility to the usual logical requirements of a science, though he emphasizes the peculiar nature of its subject as concerned with conscious beings capable of choice and learning. He does not believe that such analysis necessarily involves ideological bias. But beyond that,

in the application of Economic Science to problems of policy, he insists that we must acknowledge the introduction of assumptions of value that are essentially incapable of scientific proof. For this reason, while not denying the value of some thought going under that name, he urges that the claims of Welfare Economics to be scientific are highly dubious. He then goes on to argue the lack of realism which is involved by some of the inferences which may be drawn from the assumptions of Welfare Economics.

In the place of Welfare Economics, Robbins recommends what he calls Political Economy which, at each relevant point, ought to declare all non-scientific assumptions. He next furnishes some indications of the leading criteria and fields of speculation which should underlie this intellectual field.

In his conception of the task of Political Economy, he believes that "as teachers of the subject, our instructions will be more fruitful if, side by side, they run parallel with suitable courses in Politics and History—Politics because it deals systematically with philosophical and constitutional matters which as regards Political Economy only arise incidentally; History, because while it certainly does not lay down laws by which we can foretell the future, it does give a feeling for the possibilities of action. . . . I fancy that such exhortations are more at home in my own country where excessive specialization in the first-degree stage, productive of one-eyed monsters, is too frequently the order of the day."

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## *Political Economy, Politics, & Paradigm Shifts*

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**Salim Rashid**

University of Illinois

Review Essay of *The Economist in Parliament*. By Frank Whitson Fetter. Durham, N.C.: Duke University Press, 1980; & *Economic Doctrine and Tory Liberalism, 1824–1830*. By Barry Gordon. London: The Macmillan Co., 1979. In *History of Political Economy* 13 (Winter 1981): 860–864.

Students of classical economics owe an enormous debt of gratitude to the pioneering studies of E.R.A. Seligman and Frank Whitson Fetter. Seligman, in 1903, directed attention to such previously ignored 'lesser' classical economists as Nassau Senior and Mountifort Longfield. Fetter further broadened the horizons of economic history by his careful study of early 19th-century periodicals. His research of the sources and social context of classical economics culminated in his book, *The Development of British Monetary Orthodoxy, 1797–1875* (1965). Fetter continued illuminating the drama of classical economics by detailed discussions of economic arguments used in Parliament. He presented this analysis in

his two volumes, the first being an excellent account of Ricardo's years in Parliament, *Political Economy in Parliament*, and the second being the volume reviewed in Rashid's essay. Barry Gordon's *Economic Doctrine and Tory Liberalism* similarly clarifies our understanding of the strange ways in which political economy influenced British parliamentary politicians.

Professor Fetter's *The Economist in Parliament* studies those parliamentarians who performed serious economic analysis. Mainly Whigs and Radicals, they entered Parliament with a sense of a reforming mission. They sought to advance public education, remove the legal privileges of the Anglican church, curb imperialism, and achieve democratic

electoral reform. Those Tories who joined the ranks of these reformers did not hold fast to Tory economics but rather endorsed the new political economy. Fetter's two chapters on government regulation—of working conditions and of business practices—reveals how willing the economists were to compromise their faith in *laissez faire*.

Barry Gordon's *Economic Doctrine and Tory Liberalism* chronicles the paradoxical role of the Tory Party leaders in forcing free trade and some of the tenets of political economy on Britain's Protectionists. The old Tories were baffled by the conversion of their leaders to the Smithian free trade and anti-protectionist policies of political economy.

Both Gordon and Fetter erroneously believe that Smithian classical economics was a new beginning, a first systematic attempt to apply rational thinking to economic problems. In fact, commercial, capitalist society and economic theory arose in England around 1660. As Wil-

liam Grampp convincingly showed in "The Liberal Element in English Mercantilism" (1952) Smith differed from his predecessors not in espousing freer trade but in his world view that believed in the automaticity of full employment in free-market economics. Smith, however, opened a Pandora's box by allowing unprincipled *ad hoc* exceptions to his free trade beliefs. We need to investigate what higher principles Smith and others invoked in order to go beyond the principles of political economy.

Both volumes underline the intimate relationship between economic and political power. Left unanswered is why such a high percentage of Tory leaders converted to the new Smithian paradigm of 'political economy' after 1815: Canning, Castlereagh, Peel, Huskisson, Robinson, Wallace, Courtenay, and even Wellington. Rashid suggests that it was not so much rational understanding of the principles of political economy as prestige and awe that effected the conversion to the new paradigm.

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## *Schumpeter and Papal Social Theory*

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Dale L. Cramer and Charles G. Leathers

University of Alabama

"Schumpeter's Corporatist Views: Links Among His Social Theory, *Quadragesimo Anno*, and Moral Reform." *History of Political Economy* 13 (Winter 1981): 745-771.

**J**oseph Schumpeter was one of several prominent social thinkers of the first half of our century to attempt an analysis of the legitimacy crisis afflicting capitalism during that period. Profs. Cramer and Leathers outline Schumpeter's diagnosis of capitalism's malaise, and they assemble hints from his writings and speeches concerning a likely remedy for this unsatisfactory situation. In the course of their discussion, they find close and perhaps not fortuitous parallels between Schumpeter's views and views expressed in the first two papal social encyclicals:

*Rerum Novarum* and *Quadragesimo Anno*.

Schumpeter saw the sociopsychological foundations of capitalism to be in a state of rapid collapse. He perceived the cause of this debacle in the break-up of family arrangements which had hitherto allowed the bourgeoisie to serve as the governing class of Western society. The socially redeeming value of bourgeois individualism was its long-range character. The real basis of the old entrepreneur's effort and drive was his desire to move his family into a higher social

status and a more secure economic situation. Dynastic motivation tended to cause the entrepreneur to take the long view and to acquire assets not necessary for his own short-run satisfaction.

The rise of the anonymous public corporation has drastically reduced the familial aspect of economic activity in capitalist countries. In its place, there has arisen a trend toward short-run profiteering in which managers directing the corporation concentrated more and more on end-of-the-year profit statements and their individual advancements.

Interestingly, both Popes Leo XIII and Pius XI likewise stressed the primacy of the family unit in society along with the natural right of property ownership. Leo wrote that the individual right to property can be "seen in a much stronger light if . . . considered in relation to man's social and domestic obligation," i.e. his family. Capitalism fostered the "evil of individualism" which tended to undermine family integrity and solidarity in favor of an unbridled pursuit of personal gain. Similarly, Leo viewed socialism as an illegitimate system because it threatened to disturb the family.

Thus, clear parallels exist between Schumpeter's and the Popes' analyses of the sickness of Western society. Their prescriptions for a cure show certain resemblances as well. Profs. Cramer and Leathers admit that Schumpeter's views

in this regard must be gleaned and reassembled from various writings and lectures. Nonetheless, they believe they find strong evidence that Schumpeter favored (at least ideally) the establishment of a corporatist society. Under such a system, voluntary associations would cooperate toward the orderly and mutually beneficial development of the economy—without substantial intrusion by the state. Such groups closely resemble the "vocational associations" proposed by Pius XI in *Quadragesimo Anno*. Schumpeter specifically referred to that encyclical in a 1945 speech in Montreal as he discussed the possibilities of reform.

In that same speech, however, Schumpeter indicates that, before corporatism could be implemented in the West, a "moral reform," a basic change in human values, would have to take place. Pius XI would concur, setting forth Christian values as a prerequisite for the establishment of a just society. For Schumpeter, moral reform meant something more secular, namely a rejection of the hedonistic, short-sighted, and narrowly focused ideas of utilitarian individualism. In a democratic society, stripped of its liberal fallacies, it would be possible to erect a corporatism in which the war of conflicting interests would be replaced by harmony and cooperation between related economic interest groups.

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## Political Economy & Geology

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**Salim Rashid**

University of Illinois at Urbana

"Political Economy and Geology in the Early Nineteenth Century: Similarities and Contrasts." *History of Political Economy* 13 (Winter 1981): 726-743.

**I**n the first half of the nineteenth century, political economy was the most popular social science in England, while geology was the most popular natural

science. Popular interest was no doubt heightened by the belief that both subjects were advancing and by the widespread opinion that the British were

the leaders in both fields. Newspapers of the day and major periodicals made it a point to present extended accounts of the progress of both subjects.

It was no accident that both economics and geology made great strides between 1775 and 1830. These were the years of the Industrial Revolution and rapid economic growth. The consequent necessity of rethinking economic questions was the chief cause of the superiority of the British in this field. The influence on geology was more indirect. The minerological needs of the Industrial Revolution stimulated work on geological maps and led to the valuable maps of William Smith and others. James Hutton even wrote a paper on how best to distinguish coal from culm for purposes of taxation.

Since the two sciences were popular, it was not uncommon for men to maintain an active interest in both subjects. At its meetings, the Geological Society regularly discussed current economic problems, such as those connected with currency or the Corn Laws. In the other direction, no less an economist than David Ricardo regularly attended sessions of the Geological Society.

The different methodological biases of the two nascent subjects may best be seen by considering the salient doctrines of the period. Surprisingly, Adam Smith's great work left no clear methodological guidelines. The principal effect of *The Wealth of Nations* was to make a new metaphysical value judgment acceptable to serious thinkers: i.e. the existence of a

pre-established harmony in economic affairs.

The corresponding judgment which evolved in geology was the acceptance of Time as the sole source of change in the geological world. Providence was no longer called upon to act in the geological universe. Geology was thus important in providing the first major example (soon to be followed by biology) of a subject concerned with the *causal* analysis of past events. From the twentieth-century viewpoint, the economists intruded a nonscientific presumption into their subject, while the geologists dispensed with one.

It was not until David Ricardo's *Principles of Political Economy and Taxation* in 1817 that economics came to possess a tightly knit, coherent, but largely *abstract* structure. The theoretical framework for geology erected by James Hutton presented a considerable contrast to Ricardo's. In Hutton's structure, a closer correspondence between fact and theory was continuously maintained. Hutton argued that the most important geological forces were those of erosion and denudation in combination with subterranean volcanic forces.

The sway of *a priori* notions in political economy eventually led to questions about its scientific character. By 1878, Sir Francis Galton went so far as to propose the removal of Economics (Section F) from the British Association. On the other hand, geology, with its emphasis on precise measurements and definite laws, was able to preserve its prestige intact.

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## *The Economic Theory of Property Rights*

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Pedro Schwartz

"The Market and the Meta-market: A Review of the Contributions of the Economic Theory of Property Rights." Documento de Trabajo 1980-1981. Working Paper from the Instituto de Economía de Mercado (Nunez de Balboa, 39; Madrid, Spain), 29 pages.

**T**he author's object is to summarize a new and fruitful development in economic thought, the economic theory of

property rights. Although economists have been concerned with property rights and the legal organization of soci-

ety since the 18th century, it is only recently that they have begun to try to define with precision the relationship between the institutional meta-market and the economic market. It was only after 1960 that there was a rebirth of interest on the part of economists in the economics of property rights and the reciprocal influence exerted between the market and society's legal institutions. A recent development in this trend has been the spread of this kind of analysis to all aspects of Law, so that we now see the emergence of an "economic theory of law." The author wishes to show the importance of such developments to economists, sociologists, anthropologists, and students of the law.

The author traces the starting point of the new analysis of the economics of property rights to Ronald Coase's "Coase's Theorem" (originally formulated in 1960 as a solution to the problem of externalities). Coase defined three conditions under which it was a matter of indifference to whom property rights were attributed: whatever the attribution the market would reach an optimum if: (a) the property rights were clearly defined; (b) transaction costs were zero; and (c) payments originating in the transactions through which the optimum was reached did not alter the pattern of demand.

Certain practical conclusions can be drawn from the first two of these three conclusions: for example, that it is convenient that the system of property rights should be universal; and that it is advantageous constantly to introduce improvements into the functioning of the market process so that transaction costs be reduced. It is better, therefore, that all things belong to someone, and that deals with owners should be facilitated. This conclusion suggests a research program into the defects of communal property, which is of special interest to economic historians.

Given that conditions (a) and (b) may not fully obtain in reality, even in such efficient markets as the great stock exchanges, society is confronted with the need, not of directly intervening to correct market failure, but rather of improving its functioning indirectly by a correction of meta-market or institutional framework. Posner's Hypothesis provides us, argues the author, with the analytical instrument for this task. According to this hypothesis legal institutions can be economically analyzed in order to determine to what extent they further economic productivity. The meta-market shows a tendency continually to redefine property rights, as technological conditions in supply, or tastes in demand, change; also, when transaction costs are high, it tends to grant property rights to those who will use them most productively.

This analysis offers a critique of the growing government intervention in the economic market which has taken place in our century. This analysis indicates that the market works well enough if left alone and that a spontaneous evolution of the non-political institutions of the meta-market favors a growing efficiency and 'economism' of life in society.

This critique of government intervention is reinforced when Coase's third condition is examined. This condition demanded that payments made to transact with property owners should not affect the pattern of demand. Hence, the use of resources by pressure groups to obtain concessions from the government implied that society would reach a sub-optimal state.

In sum, perhaps the social problems we face are not the alleged defects in the economic market but rather the result of the malfunctioning of the political meta-market with its intervention into property rights. □



# II

## Law & Philosophy

Because of its practical and theoretical significance, the theme of Law and Philosophy has repeatedly found expression in sets of summaries within the pages of *Literature of Liberty* (see, most recently, in the Spring 1982 issue, "Legal Philosophy & Norms," pp. 43–50, and in the Summer 1982 issue, "Law, Politics, and Freedom.")

Legal doctrines and legal philosophy crucially determine the possibility of a decent and humane society. Thus, Rosenfeld's opening summary dramatizes the contrasting effects of a legal code implementing individual rights or utilitarian, "social good" consequentialism. Likewise Vandeveld's following summary underlines how evolving legal definitions of property can lead to either peace and prosperity or controversy and economic decline.

Other themes surveyed are the meaning of natural law in terms of legal standards (see Carbonneau together with Donnelly, Scully, Veatch, and Finnis), the economic ramifications of tort law history (Schwartz), the debate in common law over strict or broad interpretation of contracts (Trakman), the legal and economic significance of corporate legislation (Amsler-Bartlett-Bolton, Williamson, and Urofsky). Finally, David Williams' article surveys the history and problematic legal status of political surveillance, and Robert M. Cover deals with the parallel issue of illegal government attacks on the First Amendment right of political dissent and civil liberties in America during the "Red Scare."



## Individual Rights vs. Utilitarian Consequences

M. Rosenfeld

"Between Rights and Consequences: A Philosophical Inquiry into the Foundations of Legal Ethics in the Changing World of Securities Regulation." *George Washington Law Review* 49 (March 1981): 462-538.

The once sacred citadel of American individualism has become increasingly undermined by an endless proliferation of bureaucratic regulation. At the very same time, the modern attorney, especially the corporate attorney, finds himself immersed in a rising tide of conflict and confrontation. According to Prof. Rosenfeld, these two developments are not unrelated. The individual's loss of power entails a corresponding constriction of the latitude enjoyed by his legal representative. Rosenfeld seeks to demonstrate that the nexus between the fate of the individual and the role of the attorney is much stronger than one of mere correspondence. It proves rather to be one of interdependence and mutual determination.

Individualism in the West has tended to move back and forth on a continuum bounded by two poles: the theory of rights and utilitarian consequentialism. Essentially, the first point of view, exemplified by John Locke and Adam Smith, postulates a whole range of rights which allow the individual to pursue his self-interest with as few fetters as possible. These rights are to be protected whatever the moral consequences in particular cases, since, according to the theory, rights have primacy over morality—although people's pursuit of self-interest will normally, even necessarily, lead to the common good.

Consequentialism, in its broadest sense, holds that the moral value of an act must be determined from its consequences. A characteristic attitude of utilitarianism, consequentialism rejects the proposition that the mere pursuit of individual self-interest necessarily leads to the common good. Bentham and his

followers adhered to a "combination of laissez-faire economics with a reiterated demand for political reform." The heirs of Adam Smith in the economic sphere, they demanded "a harmonization of interests" through legislation in the political and social spheres, thus departing from the minimal state model of Smith and Locke.

This gap between politics and economics was not closed until J.S. Mill made his fundamental "discovery" that the "true province of economic law [is] production and not distribution." Mill thus freed the social distribution of economic goods from the vagaries of the "invisible hand" and thereby opened up the possibility that government might licitly impose its moral values to ensure a just share of wealth among all persons. Mill's views on redistribution led directly to such experiments as the New Deal which have fostered the "revolution of rising entitlements" underway in many Western countries. That revolution has greatly expanded the material security of individuals—at the price of constricting the range of rights to pursue self-interest.

This development has put the modern corporate attorney in a highly ambiguous position. In an individualist society committed to the theory of rights, the attorney's role is clear: to defend his client's interests even at the risk of threatening the legitimate interests of others. However, in a consequentialist society, the attorney finds himself torn between the interests of his client and those of society. Thus, for example, the Securities and Exchange Commission could take the position in 1978 that, under certain circumstances, a corporation's securities counsel has the

obligation to divulge his client's confidences to the corporation's shareholders, to the Commission, and, in effect, to the investment public.

For Prof. Rosenfeld, the dilemma of the modern attorney is a metaphor for the paradox of the individual in our times. Bereft of the sanction of the in-

visible hand, the individual is caught in a morass in which the pursuit of self-interest is increasingly viewed as inimical to the common good. Attempts to reconcile the two with regulations drastically limit the freedoms of a "free" society, while rendering the moral morass still deeper and murkier.

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## *Shifts in the Meaning of Property*

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**Kenneth J. Vandevelde**  
Harvard Law School

"The New Property of the Nineteenth Century: The Development of the Modern Concept of Property."  
*Buffalo Law Review* 29 (Spring 1980): 325-367.

**T**he concept of property has been central to the development of both public and private law throughout the history of the United States. During those two hundred years, however, the meaning of the term "property" has changed radically. Prof. Vandevelde's article traces the main transformations of the concept of property from the Revolutionary period down to our own day.

In broad outline, Vandevelde's thesis is this: at the beginning of the nineteenth century, property was ideally defined as absolute dominion over *things*. Under this absolutist and physicalist conception, the law of property was based on a taxonomy of things—with the nature of each thing determining its treatment at law. "Real property" consisted of things which were fixed and immovable (such as land and tenements), while "personal property" comprised movable things (such as money and goods).

Real property was further divided into "corporeal hereditaments" (land) and "incorporeal hereditaments" (advowsons, tithes, commons, ways, offices, dignities, franchises, corodies, annuities, and rents). Incorporeal hereditaments presented a conceptual problem for the great legal systematizer Blackstone, since the holder of such property held no thing—only a right, albeit a

right issuing from a thing. Blackstone solved the problem by reifying these rights. They became "things," though in name only.

As the nineteenth century progressed, numerous exceptions to the physicalist elements of Blackstone's conception of property were incorporated into the law. Acting at times on a theory of natural law and at other times on the instrumentalist public policy of a positive state, courts increasingly sought to protect *value* as property, even though no thing was involved. Soon any valuable interest could be declared the object of property rights. This process of dephysicalization threatened to place the entire corpus of American law in the category of property—a conceptual imperialism which created severe problems for the courts.

The absolutist conception of property also came under assault. Throughout the nineteenth century, courts discovered that some interests which deserved protection could not be protected absolutely without unduly restricting the activity of others. Courts thus created less protected forms of property. However, once they admitted that all property was not equally protected, the designation of an interest as "property" could no longer provide a basis from which legal rights

could be automatically deduced. As a result, such a designation no longer settled a controversy. It merely restated the dispute.

By the beginning of the twentieth century, a new conception of property emerged and was stated in its definitive form by Wesley Newcomb Hohfeld. The new property was defined as a set of legal relations among persons. Property was no longer conceived as dominion over things. Moreover, property was no longer absolute, but limited, with the meaning of the term varying from case to case.

The new conception of property failed to solve the problems caused by the decay of the Blackstonian conception. Courts

still had to decide whether a particular interest was property, and, if it was, how much protection it merited. The new property concepts proved unable to settle controversies and to legitimate results. Courts overcame their paralysis by deciding cases with overt recourse to political categories. In so doing, however, they abandoned the myth of judicial neutrality and, with it, their own legitimacy. The "government of laws and not men" which had seemed clearly to exist to Chief Justice Marshall had been exposed as, in truth, a government of "nine old men." The creation of the new property was, in microcosm, the destruction of the rule of law.

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## Balzac on Natural Law vs. Corrupt Law

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**Thomas E. Carbonneau**

Tulane University School of Law

"Balzacian Legality: A Proposal for Natural Law Juridical Standards of Legitimacy." *Loyola Law Review* 27, no. 1 (1981): 1-39.

Since its publication in the nineteenth century, Honoré de Balzac's (1799-1850) *Comédie Humaine* has been praised for its incisive observations of the social milieu of its time, as well as for its detailed descriptions of the world of commerce and finance. The accuracy of Balzac's social observations, however, also extends to his treatment of the law.

Balzac's personal experience in and intimate acquaintance with the law is unique, at least in the annals of French literary history. He was one of the few French writers to hold a law degree and to have clerked in a law office. Prof. Carbonneau devotes the greater part of his article to an analysis of the social function of law in Balzac's novel *Les Illusions Perdues*. As the title suggests, the novel describes the confrontation between purity of ideals and the corrosive immorality of society, a theme that runs through the fabric of many Balzac novels.

In this narrative, Balzac tells how the unscrupulous Boniface Cointet defrauds an idealistic inventor, David Séchard, of a secret process which will surely revolutionize the paper-making industry. Balzac shows that the only weapons Cointet needs to secure his goal are an acute knowledge of human nature and a familiarity with the technicalities and loopholes of the commercial code. Significantly, his plan includes the cooperation of the solicitor, Petit-Cloud, whose enormous desire for success is buttressed by an utter insensitivity to the ethics of his profession. Through a series of stealthy, but perfectly legal maneuvers, Cointet gains control of Séchard's paper-making formula.

Throughout his story, Balzac attempts to highlight the inconsistencies between the application of the laws and their theoretically expressed purpose. As he saw it, the origin of the law's perverted use lay in the fact that, even though it

affects all men, its rules and purposes are known only to a small minority of interested parties. This ignorance of the law on the part of the majority is not the result of an intrinsic lack of intellectual ability. Rather it stems from the entanglement of legislative provisions and from the befuddling complexity of the legal process. Thus does the legal system invite its own subversion by an elitist manipulation of its technicalities. The laws cease to refer to a higher standard of what is just and instead become tools for the aggrandizement of a privileged few.

For Balzac, the use to which law is put in a particular society depends less on its theoretical foundations than on the social mores which predominate. He saw law in his day as the instrument of an

unbridled individualism in which respect for natural Justice bowed before the Machiavellian attitude that morality is irrelevant to the assessment of man's conduct in society.

From all this, Prof. Carbonneau concludes that the Balzacian vision of law is closely akin to natural law norms. The legal devices invented by men can serve no legitimizing function in society, unless the men who promulgate and administer them identify them with an overriding moral sense. Unless legislators instill the legal system and its judicial offices with moral consciousness, law, instead of cultivating and refining man's precious humanity, will turn against it and finally destroy it.

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## *Aquinas and Natural Rights*

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**Jack Donnelly**  
Tulane University

"Natural Law and Right in Aquinas' Political Thought." *The Western Political Quarterly* 33 (December 1980): 520-535.

**A** linguistic analysis helps clarify a problem in the history of political thought: Aquinas' theory of natural law and its application to the problem of obeying unjust law. Aquinas' theory can be understood only when we pay careful attention to its specific linguistic features, and in particular to the meaning of the central concept, "right" (*jus*). A distinction is drawn between two senses of "right" ("right that" and "right to"). This distinction is important not only for the light it casts on the difference between high medieval and modern political thought, but in itself and for its relevance to contemporary discussion of human "rights." After sketching Aquinas' theory of law, with particular reference to natural law, the author raises the central problem—what ought to be done in the face of unjust laws and a

tyrannical ruler? The last sections of the article elucidate the basis for Aquinas' answer that, in most cases, the tyrant must be endured.

For Aquinas, unjustified or unauthorized action against even an unbearably vicious tyrant is not only no better in kind than the acts of the tyrant, but it is much more dangerous. Resistance is likely to produce faction, sedition, and even civil war, thereby forfeiting all the benefits of political society in the attempt to remedy a few of its contingent defects. Aquinas finds himself in a dilemma, torn between the two central functions of human law, restraining evil and fostering virtue. To tolerate the human evil of the tyrant means that, at least temporarily, we must renounce the fostering of virtue as a primary goal of law. By requiring obedience to the tyrant, he

deprives citizens of the protection of the natural law by abrogating its binding force and its priority over human law.

The conceptualization of Aquinas' treatment of the problem of unjust laws is misleading since it suggests an embryonic theory of natural or human rights in Aquinas' notion of natural law. Donnelly believes that such notions are totally absent from Aquinas and discusses in great detail the relation of justice, right, and law in Thomas' thought. His crucial distinction is between two senses of "right": "right that" (as "It is right that Smith do X,") and "right to" (as "Smith has a right to X"). Aquinas acknowledges only one right ("right that"). Aquinas' *jus* is a different concept from our modern notion of human "right." For Aquinas natural law does not give rise to "rights" in the sense of "right to" but only states what is right in the sense of "right that."

A tyrant is acting evilly and unjustly and it is not "right that" he violate God's natural law, but he owes his moral obligation to God and not to his citizens. For Aquinas, citizens cannot (except by anachronistically invoking modern rights theory) claim that they have a "right to" resist or possess a "right to" self-government that "entitles" them to



depose a tyrant or establish a ruler of their choice. Aquinas subscribes to a view of politics which formulates what is right almost exclusively in the sense of "right that" and which also wholly lacks the idea of natural or human "right to." Injured citizens have available to them, within Thomas' framework, claims which they are not entitled to enforce. "The demands of natural law may be quite considerable, but the position of the people in a political system based on such a view of natural law, and the operation of the system, would be quite different from one based on natural or human rights."

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## *Man's End, Society & State in Aquinas*

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Edgar Scully

"The Place of the State in Society according to Thomas Aquinas." *The Thomist* 46 (July 1981): 407-428.

**A**quinas' theory of the state takes off from Aristotle's formula, "Man is by nature a political animal," but then goes beyond it in several important respects that stress the importance of society and individuality in reference to the state's claims.

Man is naturally a political animal because the laws of the state are ordered

to fulfill man's need for a life of virtue, just as the family and household are ordered to fulfill man's daily needs. Further, man's ability to communicate through speech about the just and the unjust is fulfilled in the state. Also man has a unique need for friendship, and the state establishes a social atmosphere in which friendship is possible. As distinctly

human virtues, the cardinal virtues of prudence, justice, fortitude, and temperance are all *political* virtues since they can be commanded by the legal justice of the state. On the other hand, insofar as these same virtues are ordered to God as man's supernatural end, there is an area of human action that is above and beyond the jurisdiction and competence of the state.

The growing complexity of medieval society, the development of urban and commercial life, tended to make the political come to be identified with "government" alone. Accordingly, Aquinas emphasized that man is both a political *and* a social animal. He thereby affirmed that the governmental dimension of society should not be divorced

from the interests of society. He also intended to affirm that the religious and private life of the people is not part of the political order, thereby limiting the supremacy of the state.

Since man is a social animal, Aquinas inferred that man must be ruled by some governing agency to care for the common good, or else the group would disintegrate. Humans may pursue their own good on their own, but the common good is a distinct effect over and above individual goods and it therefore requires a distinct cause to promote it. A governing power is such a cause without which man's social nature cannot be fulfilled. The state, however, is always at the service of the body politic and society as a whole.

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## *Natural Law & Professor Finnis' Book*

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**Henry Veatch**

Professor Emeritus, Georgetown University

"Natural Law and the 'Is'-'Ought' Question."  
*Catholic Lawyer* 26 (Autumn 1981): 251-265.

**A**t the beginning of his article, Prof. Veatch offers a tribute to John Finnis' book, *Natural Law and Natural Rights*. He views it as a remarkable achievement which has almost singlehandedly restored natural law to serious consideration among contemporary philosophers.

Despite his admiration, however, Veatch takes issue with one crucial section of the book, the part entitled "The illicit inference from facts to norms." The very title of the section seems to negate the legitimacy of basing norms on factual data. "Yet," Veatch asks, "how can the enterprise of a natural-law ethics be anything other than a search for some basis for morals and ethics in nature itself, and thus in the facts of nature?"

In Veatch's view, Finnis interprets Aquinas as maintaining that the first

principles of natural law are not inferred from metaphysical propositions about human nature, or from propositions about the nature of good and evil, or about the function of a human being. Nor are they inferred from a teleological conception of the ends and purposes of nature or any other conception of nature.

In order to maintain a wall separating norms from nature, Veatch asserts, Finnis (like Germain Grisez) puts forward the Aristotelian distinction between practical and theoretical sciences—an entirely legitimate distinction, Veatch admits. Since ethics is a practical science, it is established on the first self-evident principle of practical reason, enunciated by St. Thomas as: *Bonum est faciendum et prosequendum, et malum vitandum*. Grisez carefully

translates this admonition as: "Good is to be done and pursued, and evil is to be avoided."

According to Grisez, good has the intelligibility of a purpose or end, "good being simply what each thing tends towards." Veatch objects that, if good is to be construed simply as an end or as an object of inclination and desire, a dangerous ambiguity immediately arises. He explicates this ambiguity with what he calls "the *Euthyphro* test." In Plato's dialogue *Euthyphro*, Socrates raises the question of whether a thing is said to be good because it is beloved of the gods; or rather is it beloved of the gods because it is good?

According to the *Euthyphro* test, if goodness and value are entirely relative to tastes and inclinations, no grounds exist for holding that good is anything to be done (*faciendum*), to be pursued (*prosequendum*), or that evil is to be avoided (*vitandum*). Grisez must go beyond his statement about goods as inclinations to specify that they are objects of inclination in the sense of being things

that we *ought* to be inclined towards—whether we actually are or not. This means that goods are not goods only because they are desired, but good in themselves—goods as beings. To obviate the ambiguity posed by the *Euthyphro* test, good must not only be considered according to practical reason, but also in its metaphysical dimension. Clearly, there can be no such domain of practice or practical reason, unless it be in terms of metaphysics and of theoretical reason through which it receives its proper determinations.

A breach has thus been effected in the wall of separation between practical reason and theoretical reason, between ethics and metaphysics, between nature and morals, between "is" and "ought." Without such a breach, Veatch comments, one might envision both Finnis and Grisez treading on a slippery slope into an ethics of *nomos* (convention) rather than *physis* (nature)—an ethics which is so prevalent today and so irreconcilable with anything resembling an ethics of natural law.

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## Professor Finnis Replies

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**John Finnis**

University College, Oxford

"Natural Law and the 'Is'-'Ought' Question: An Invitation to Professor Veatch." *Catholic Lawyer* 26 (Autumn 1981): 266–277.

**I**n his reply to Prof. Veatch, John Finnis finds that none of Veatch's basic questions and objections properly apply to either himself or Germain Grisez. Finnis denies that either he or Grisez has published anything that can reasonably be interpreted in context as asserting that ethics has no basis in the facts of nature, that a wall of separation divides "is" from "ought" and facts from values, that there is an absolute independence of ethics over against metaphysics, or that human good is an end or ends which human beings have an inclination towards

rather than the ends that perfect human beings.

Given such a basic misunderstanding of his and Grisez' position, Finnis makes a two-fold invitation to Prof. Veatch: first, to *read* strictly and fully what he and Grisez have written; then second, and more importantly, to examine some of the serious questions which his book *Natural Law and Natural Rights* addresses to those who interpret Aquinas and Aristotle in Veatch's manner.

Who would guess from Veatch's polemic, Finnis asks, that he had reached

the same result in his book using the *Euthyphro* test as Veatch did in his article? Finnis did this prominently in chapter III, which contains a detailed examination of the nature of judgments concerning human good, by means of an exploration of our judgments regarding one particular basic human good—knowledge or truth.

Having devoted more than a chapter of his book demonstrating it, Finnis obviously favors the idea that metaphysics is a part of (and in a sense the fundamental part of) the great search for clarification and explanation. In the book, he openly called his demonstration “not practical but theoretical or metaphysical.” He also claimed that answers to the theoretical or metaphysical questions raised in the chapter are *necessary* if there are to be any fully satisfactory answers to the deepest practical questions about the topic of human good.

However, Finnis also claimed—and this is what Veatch seems to object to—that just as “a *good explanation* of molecular motion can be provided” without explaining the dependence of the universe and of molecular motion on the

uncaused cause, “so too . . . natural law can be understood, assented to, applied, and reflectively analyzed” without exploring the metaphysical questions to which Finnis referred.

Finnis’ statement simply gives serious consideration to Aquinas’ frequently repeated claim that *even rustics understand the natural law*. Following the *Summa Theologica* I–II q. 58, a. 4c, it is clear that one can indeed be morally upright without speculative (i.e. theoretical, ‘is’ knowledge) wisdom (*sapientia*, evidently *stricto sensu*), without the practical knowledge of craftsmen (art), and without speculative knowledge (*scientia*). To admit this does not negate the ultimate importance of metaphysical principles to the derivation of practical ethical norms.

Finnis comments in conclusion that: “This (his and Grisez’) pedagogical order of priorities seems to be more faithful to the content of Aristotle’s and Aquinas’ theories of ethical knowledge. It has the disadvantage, I acknowledge, of requiring the reader to attend to more than occasional sentences in fragments of our respective works.”

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## 19th-Century Tort Law & Industry

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**Gary T. Schwartz**  
UCLA School of Law

“Tort Law and the Economy in Nineteenth Century America: A Reinterpretation.” *The Yale Law Journal* 90 (8) 1981: 1717–1775.

**A** prevailing view among American tort law historians maintains that nineteenth-century tort doctrine was deliberately structured to accommodate the economic interests of emerging industry. According to these scholars, American courts jettisoned a potent pre-nineteenth-century rule of strict liability in favor of a lax negligence standard, leniently applied that standard to

enterprise defendants, administered a severe defense of contributory negligence, and placed strong controls on negligence law under the name of “duty.” Prof. Schwartz’ article systematically challenges these premises first by assembling pre-nineteenth-century background material in tort law cases and then by examining important nineteenth-century tort cases tried in

the states of New Hampshire and California.

A study of pre-1800 English tort doctrine and of early American models reveals no consistent distinction drawn between areas covered by strict liability and those governed by a negligence standard. Ambivalence more than clarity predominated in the application of these norms to such disparate areas as fire, collision, animal, and employer cases. Prof. Schwartz finds however that the available evidence disputes the notion of a strong pre-nineteenth-century strict liability tradition. Instead, strict liability strands in older English and early U.S. law seem blurred, while the negligence strands appear both more distinct and capable of extended application.

Turning to New Hampshire and California case law, Schwartz disputes the notion that the nineteenth-century negligence system can properly be characterized or disparaged as an industrial subsidy. On the contrary, the Supreme Courts of the two states expanded on the negligence standard in ways that rendered it both ambitious and demanding—narrowing in the process the gap between negligence and strict liability. Far from erecting a duty prerequisite to every tort claim, the Courts easily recognized that everyone has a general duty to everyone else to avoid negligent behavior.

The record in New Hampshire and California reveals no tendency on the part of judges to shelter emerging industries from what otherwise would be their liability in tort. If anything, novel forms of risk taking generated by the profit motive were viewed with enhanced, rather than reduced, suspicion. To this extent, the Courts were less influenced by, than initiators of, populist impulses.

Schwartz cites numerous examples of this judicial populism. Despite the importance of turnpikes and especially textile mills to New Hampshire's economy in the early nineteenth century, the state's Court subjected both turnpike and textile companies to emphatic liabilities.

Railroads loomed large in the latter half of the century, yet, in the New Hampshire and California Courts, railroad companies suffered defeat on the vast majority of contested issues. In opinions animated by a concern for safety, the California Court spurned a



power company's implicit request for a liability rule subsidy and held newly formed elevator companies to exacting liability standards.

Thus, the theory that nineteenth-century tort law was designed to benefit private economic interests is misleading. Evidence from two states shows that the Courts, in implementing the negligence system, were solicitous of victim welfare and generally bold in the liability burdens they imposed on corporate defendants. The overall performance of tort law in the two states studied need not be disowned as offensive or discreditable. In truth, the evidence indicates a surprising continuity between nineteenth-century tort law and the law we now recognize in the late twentieth century.

# The Letter and the Spirit of Contract Law

Leon E. Trakman

Professor of Law, Dalhousie University

"Interpreting Contracts: A Common Law Dilemma." *The Canadian Bar Review* 59 (June 1981): 241-300.

**T**he common law court traditionally has been faced with a dilemma. Should the court exercise caution and literalism in construing mercantile agreements by examining only the explicit words of the agreement in interpreting the intention of the parties? Or, by contrast, should the court be bold and creative in construing agreements and determine the intention of the contracting parties from the circumstances surrounding the transaction, from the business conventions and conceivably from the judge's own perception of what is fair and reasonable in the situation?

Professor Trakman analyzes to what extent common law judges are inclined towards a cautious or a bold approach in construing nonperformance obligations in commercial contracts. His study analyzes whether particular judicial methods of construing nonperformance obligations in contracts are functional and the extent to which they are useful in practice. The author emphasizes the philosophical values of judges, their approaches to interpretation and the link between their personal values and their interpretation of nonperformance clauses in business contracts. While recognizing that judicial ideology is essential in developing the common law, the author believes that the existence of a judicial methodology, a process of consistent reasoning, is even more fundamental if the common law of nonperformance is to ensure the viability of commerce.

Professor Trakman studies mercantile freedom of contract (autonomy) in common law and international commerce, the common law function of narrow interpretation and broad construction of nonperformance clauses, "intentionalism" and the express terms of a commercial contract, the limitations

of mercantile autonomy, judicial creativity in construing terms of a contract, judicial construction as a recourse to equity, judicial construction and the rule oriented approach, and the possibility of reform.

The process of judicial investigation progresses from an analysis of the literal terms of nonperformance clauses to a synthesis of the negotiations between the parties, their past and present business understandings and their performance expectations. Construction ought to include consideration of the type of trade practices which businessmen actually employ, their market habits, and their industry usages. What merchants reasonably intend from a judge's perspective relates directly back to what they actually intend. The probable behavior of merchants blends in with the actual behavior of merchants.

"Implied terms" are only supportable as methods of judicial construction where the fictional basis of implied terms conforms to actual values prevailing among specific merchants within identifiable environments. The "foundations" or "objects" of agreements are only viable concepts where courts are aware of the dynamic features of business, the profit and market goals that underlie trade, as well as the give and take that evolves in buying and selling in the marketplace.

The utility of judicial boldness or caution is a relative, not a constant, phenomenon. The manner of construction by courts alters as parties, markets, and trade practices alter. The form of construction serves as a means towards a functional end, not an end in itself. Ultimately, the "life of the law" lies in the actual experience of commercial practice itself as the reference point for judicial interpretation.

# The Limited Liability Corporation

Christine E. Amsler, Robin L. Bartlett, and  
Craig J. Bolton

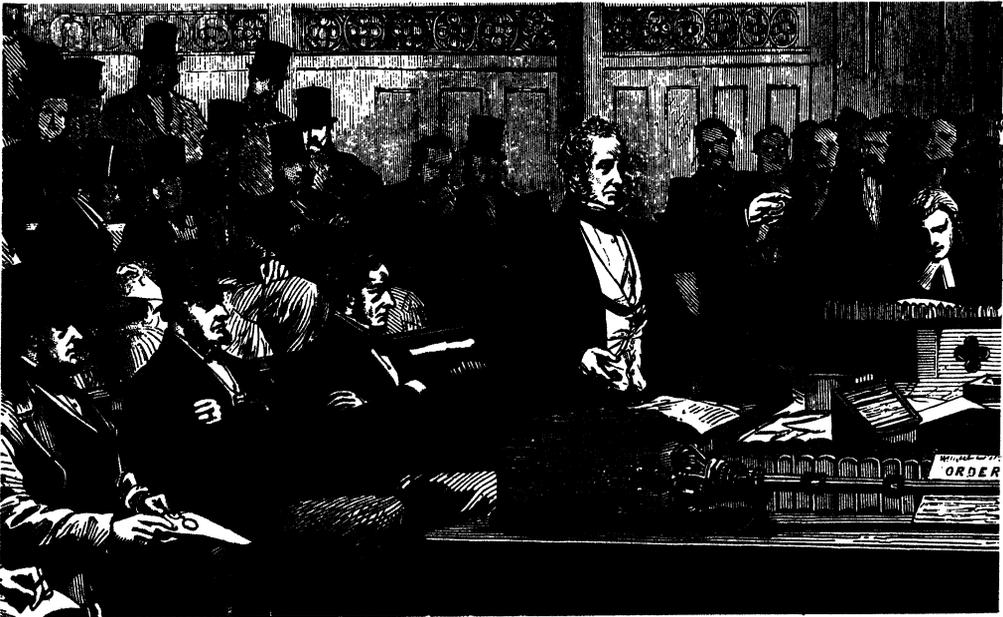
University of Pennsylvania, Denison University, and University  
of Dallas

"Thoughts of Some British Economists on Early  
Limited Liability and Corporate Legislation."  
*History of Political Economy* 13 (Winter 1981):  
774-793.

The origins and development of the limited liability corporation (LLC) have either been little studied or distorted by hostile ideological presuppositions. Contrary to popular anti-corporate mythology, the "beast of corporatism" was not spawned at the end of the 19th-century by "mature capitalism" without any previous economic analysis. The authors seek to give some background on the earlier intellectual, economic, and legal history of the LLC and raise research questions for the future. First, they trace the steady, if not always progressive, development of British common law from the 16th century down to the 1850s. Next, they examine the attitudes, pro and con, of the famous British classical economists (Smith, Senior, Tooke, J.S. Mill, and McCulloch) toward the cor-

porate form of business organization in the years before its final legal establishment. Finally, they sketch the series of Parliamentary inquiries and reforms during the 1850s and 1860s as a background to subsequent reactions by late classical and early neoclassical economists (including the seminal assessment of corporatism by Alfred Marshall).

By way of broad generalization, even in England, the birthplace of industrialization and the traditional home of legal and social pragmatism, the modern LLC had a tortured and uncertain birth. While championed by a few prestigious economists, it was vilified by many (such as John Ramsey McCulloch). Even extreme economic and legal reformers were torn between what seemed an



opportunity to benefit the poor or middle classes (by reducing their risk in investing their modest savings through legally limiting their liability) and condemnations of limited liability corporations as impractical and unjust. Even after Parliament had committed itself, in 1844 (the Registration Act) and again in 1856 (the Joint-Stock Companies Act), nearly half a century was required in order to reach a well-functioning body of statutory law. The notion that the LLC was a 'necessary' product of capitalist development appears to be historical hindsight.

Finally, it is surprising that the debate over the merits of the LLC has remained on such an elementary level.

While Williamson, Alchian, and others have analyzed in some detail Smith's and McCulloch's contentions concerning the cost effectiveness of corporate organization (see Eirik Furubotn and Svetozar Pejovich, eds. *The Economics of Property Rights*, 1974), Marshall's more complex and provocative suggestions have not been intelligently followed up. His correspondence indicates that he saw the conversion of many markets from partnerships to corporate domination as an evolutionary trend but he expressed fears of an industrial world dominated by a few large firms by reason of special legal privileges.

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## *Corporations & Transaction Costs*

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**Oliver E. Williamson**  
University of Pennsylvania

"The Modern Corporation: Origins, Evolution, Attributes." *Journal of Economic Literature* 19 (December 1981): 1537-1568.

**T**here is virtual unanimity over the proposition that the modern corporation is a complex institution which has played a crucial role in the development of modern Western economies. However, there is much less agreement on what its attributes are and on how and why it has evolved to take on its current form. Prof. Williamson argues that the modern corporation is to be understood mainly as the product of a series of organizational innovations that have had the purpose and effect of economizing on transaction costs.

After discussing the development of the basic corporate form in the nineteenth century, Williamson goes on to analyze what he considers the most significant organizational innovation of the twentieth century: the gradual shift from the centralized, functionally departmentalized or unitary (U-form) structure to the multidivisional (or M-form) configuration.

As corporation activities grew more numerous and complex at the beginning

of our century, the inherent weaknesses of the centrally governed, departmentalized company became apparent. Administrative problems such as coordination, appraisal, and policy formulation increased to such an extent that senior executives found themselves unable to handle their entrepreneurial responsibilities efficiently. U-form structure had created a communications overload in which the welter of details to be attended to hampered concentration on global goals.

Responding to this administrative glut, Pierre S. DuPont and Alfred P. Sloan devised the M-form organization for the DuPont Company during the 1920s. This new structural mode involved the creation of semiautonomous operating divisions (mainly profit centers) organized along product, brand, or geographic lines. The operating affairs of each were thus managed separately.

DuPont and Sloan saw, however, that more than a change in decomposition rules was needed for the M-form to be

fully effective. They thus created a general office consisting of a number of powerful general executives and large advisory and financial staffs to monitor divisional performance and engage in strategic planning. In this way, the M-form removed executives responsible for the destiny of the entire enterprise from routine operational activities, and so gave them the time, information, and even psychological commitment for long-term planning and appraisal. Although the structure was imitated very slowly at first, adoption by U.S. firms proceeded rapidly from 1945 to 1960. Wide acceptance of this form by European companies has occurred from the 1960s to the present.

The American advance in adopting the M-form innovation enabled the U.S. to pioneer in the development of two extremely potent corporate forms: the conglomerate and the multinational. Both structures have been severely criticized since their inception. Nonetheless, in Prof. Williamson's view, the significant transaction cost economizing effected by

both warrants more sympathetic assessments.

Specifically, conglomerates in their diversity have shown themselves to be superbly equipped for allocating resources to valued uses. The activities of the multinational, on the other hand, have been selective in a most positive way—being concentrated in the more technologically progressive industries where higher rates of research and development are reported and where technology transfer poses greater difficulties. Multinationals can smoothly transmit new technical knowledge from one national branch to another. This obviates the often thorny dilemma of a foreign company which buys information, the exact value of which will not be known until after the sale has been consummated. Thus, patterns of direct foreign investment by multinationals cannot simply be explained as the pursuit of monopoly, as is so often charged. On the contrary, these investment patterns are, on the whole, consistent with effective transaction-cost reasoning.

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## *Corporation Law & the Progressive Era*

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**Melvin I. Urofsky**

Virginia Commonwealth University

"Proposed Federal Incorporation in the Progressive Era." *The American Journal of Legal History* 26 (April 1982): 160–183.

**T**he rapid industrialization of America in the latter part of the nineteenth century brought not only enormous material benefits to the country but serious social, economic, and political problems as well. For many observers, the most ominous aspect of the transformation was the growth of corporate ownership and operation—most especially the huge firms resulting from mergers. The drive toward consolidation reached its peak between 1898 and 1901, when 2274 firms disappeared as a result of merger and

merger capitalization totalled \$5.4 billion.

Reformers of the progressive period regarded big business as a threat to democratic institutions and acted upon that perception. Louis D. Brandeis' fear of "the curse of bigness," for example, may have rested on faulty economics, but many shared his concern. On the other hand, the defenders of big business and monopolies maintained, following the principles of laissez faire and Social Darwinism, that giant corporations had

arisen from "natural causes." To interfere with their operations would not only hinder progress but adversely affect the strength of the American economy.

Given such divergent points of view, it is surprising that both the proponents of reform and the champions of big business came to support the notion of an incorporation law on the federal level. The support of each party for the proposal, however, sprang from quite different reasoning.

Reformers had seen one state after another (beginning with New Jersey) pass incorporation laws of such leniency that little or no check was being put on the tide of corporate abuse. The laws were essentially designed to convince corporations to locate their headquarters in the state concerned. If this were accomplished, the state's tax revenues would substantially increase. In the face of this trend, progressives finally abandoned any hope that corporate reform would ever occur on the state level and saw a federal incorporation law as their only recourse.

Supporters of big business, from a different vantage point, paradoxically followed the same federal strategy. They viewed the multiplicity of state regulations as a serious hindrance to the progress of corporations, which had grown to operate on a national scale. In their eyes

a federal incorporation law, strict or lax, would standardize conditions for doing business throughout the country. Such nationwide uniformity would aid the growth of corporations and stimulate the nation's economic development.

Curiously, even with widespread support for a federal law, none was ever passed. Successively proposed by Presidents Roosevelt, Taft, and Wilson, federal incorporation laws foundered on disagreements in Congress over such details as whether licenses or charters should be issued and whether labor unions should be exempt from anti-trust legislation. As a result, despite substantial agreement, Congress never enacted an incorporation law.

Nevertheless, in piecemeal fashion, Woodrow Wilson succeeded in giving businessmen and reformers much of what they had been seeking for over a decade. The Federal Reserve Act 'rationalized' the banking system. The Clayton Anti-Trust Act removed some of the uncertainty surrounding the Sherman Act, while the creation of the Federal Trade Commission gave businessmen an agency which could rule on the legality of their operations. As a result of these measures, federal incorporation, once an idea whose time had come, ultimately became an outmoded concept.

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## *The Bureau of Investigation: Political Spying*

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**David Williams**  
Cornell Law School

"The Bureau of Investigation and Its Critics, 1919-1921: The Origins of Federal Political Surveillance." *The Journal of American History* 68 (December 1981): 560-579.

**I**n the hope that legislation may bar the resumption of political surveillance, Congress is considering a comprehensive charter for the Federal Bureau of Investigation (F.B.I.). As Mr. Williams sees it, however, history provides scant grounds for optimism over the success of such laws. His article chronicles the activities

of the F.B.I.'s immediate forerunner, the Bureau of Investigation (B.I.) during the years following World War I. His study of the origins of federal political surveillance leads to several conclusions.

First of all, the tone of the B.I.'s investigative reports demonstrates not only the agency's extreme antiradicalism but

also its hostility toward ethnic and religious minorities. The bureau's narrowly conceived standards classified those who challenged the conservative political order in any way as unpatriotic or "un-American." The Irish-Americans favoring Irish independence, Jews advocating the establishment of a Jewish national homeland, civil libertarians defending the rights of dissidents, and anyone advocating the recognition of the U.S.S.R. were considered as engaged in subversive activities.

Secondly, while the B.I.'s excesses may have shocked some Americans, Congress and the president made no concerted effort to halt such abuses. Only a few liberal congressmen, lawyers, and clergymen condemned the wholesale suppression of radicals during the Red Scare. Since most Americans assumed that restrictions on the First Amendment rights of radicals were "the price of vigilance," the libertarian position attracted little popular support. The courts, along with the organized bar, reinforced the belief that the government should protect the public from pernicious radical propaganda.

Next, as head of the G.I.D., J. Edgar Hoover found that Congress and the president would tolerate the bureau's anti-radical activities as long as it seemed that its efforts were limited to silencing

dissident voices. At the same time, Hoover came to understand the importance of secrecy and confidentiality. Following the controversial deportation raids of 1920, Hoover appreciated the need to respect due process at least publicly and realized that, if the B.I. engaged in constitutionally questionable activities, these activities had to remain secret. As a result, a precedent was established. For the next fifty years, fear of adverse publicity continued to be an important, if not central, element in the formulation of F.B.I. internal security policies.

Finally, a study of the B.I.'s investigations of its critics, especially in the light of newly declassified documents, casts doubt on the widespread belief that federal surveillance abuses result from the "radical impact of the Cold War on American values and institutions." On the contrary, the development of a strong elite-dominated government as well as the gradual acceptance of government secrecy were well under way before 1945. Given their initial impetus by American involvement in World War I, the B.I.'s domestic intelligence responsibilities grew dramatically during the first Red Scare. By 1924, the foundation of a permanent surveillance apparatus was firmly in place.

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## *The First Amendment: 1918–1928*

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**Robert M. Cover**  
Yale Law School

"The Left, the Right, and the First Amendment: 1918–1928." *Maryland Law Review* 40 (3) (1981): 349–388.

**I**n the wake of World War I, American democracy felt itself severely challenged by explosive developments which were shaking the forms of political order around the world. With the political collapse of Europe, the struggle over the League of Nations, the Russian Revolution, and the rise of fascism, American democracy became a principal contender

in a global struggle for ideas and power. At the same time, Americans at home felt increasingly threatened by what they judged as political 'pathologies' brought in from abroad by immigrants and intellectuals.

It fell to the Supreme Court, as the foremost articulator of American democratic principles, to frame a response to

these challenges. The response had to occur on two levels. On the ideological level, it was necessary to mark distinctions between the American variant of capitalist democracy and the newly spawned foreign political 'pathologies'—in other words, to describe and reaffirm America's distinct mission and experience. On a practical level, it was crucial to delineate an effective defense against the political pathogens. For, while Europe was clearly the source of the disease, the very nature of the struggle—its articulation in the transnational terms of class or race warfare—was that of a potential civil war.

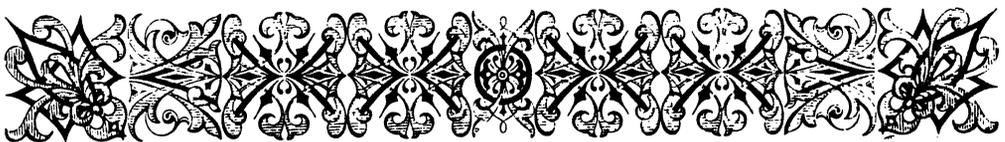
The conservatives and liberals on the High Court of that period addressed themselves to different aspects of these complex questions. For the conservatives, led by William Howard Taft, the disorderly politics of the street that had emerged in Europe and America after the war threatened not only property but civil society itself. The conservatives' dedication to the elimination of private violence was most evident in the legal weapons they provided the federal courts against picketing and organization work by unions. Nonetheless, after 1919, these same conservatives were prepared to acquiesce in some parallel restraints against the radical right. *Moore v Dempsey*, for example, implicitly overruled *Frank v Mangum* and empowered federal courts in habeas corpus cases to pierce the record and determine independently of the state court whether a state trial was dominated by a mob.

The intellectual turmoil of the period raised serious questions concerning the

legitimate parameters of dissent in American society. It was in this area that the liberals (Holmes and Brandeis) made their most important contributions. In his concurrence to *Whitney v California*, for example, Justice Brandeis began by characterizing the essential choice of political modes as being one between the "deliberative" and the "arbitrary." The essay then validates a commitment to the deliberative mode as an act of the Founding Fathers to which an ongoing commitment is always necessary.

In advocating the widest possible freedom of expression, Brandeis acknowledged the danger of allowing calls to disorderly, nondeliberative change in politics. Nevertheless, in the face of this danger, the commitment to liberty required an act of courage demanded by the very structure of our politics. For Brandeis, *law* mediates the dichotomy between the deliberative and arbitrary, between reason and force in politics. It becomes justifiably arbitrary and coercive only by remaining the product of a truly deliberative process.

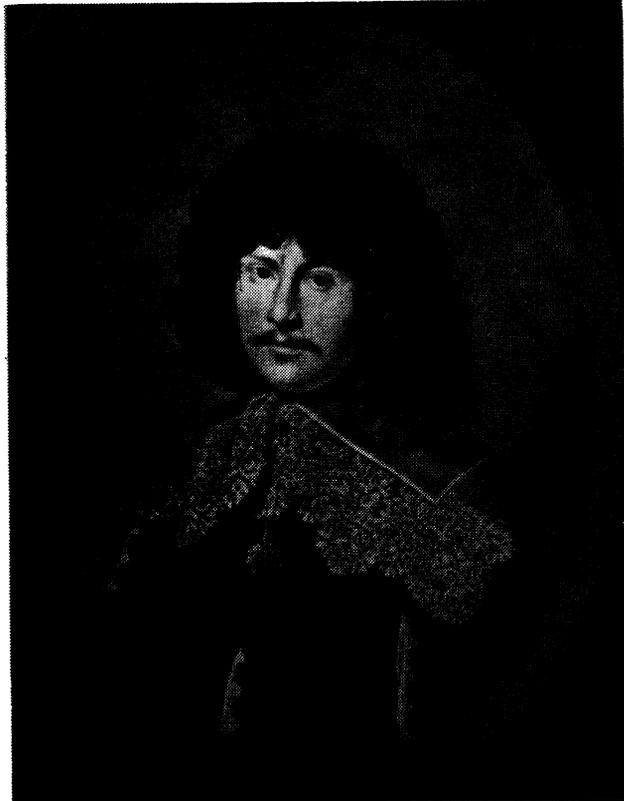
It is a measure of the distinction of the Taft Court that it posed to the country and to the world a basic dilemma: Is it possible to stop the coercive, violent forms of street politics without resorting to the arbitrary violence of the law? The conservatives had resolved to accept the force of law, the voice of the then dominant community groups. Justices Brandeis and Holmes, on the other hand, expressed a different faith and a resolve to have it both ways. □



# III

## Social Theory

The following set of summaries surveys a variety of topics pertinent to the liberal tradition, ranging from John Locke's 17th-century radical defense of property and individual rights (see the Richards-Mulligan-Graham opening summary) to Harriet Martineau's sociological thought. Other liberal social theorists covered include: Jefferson, Fisher Ames, John Stuart Mill, and Tocqueville. The second summary tellingly distinguishes James Harrington's political methodology from the geometric scientism of Thomas Hobbes. Harrington's liberal republican intellectual progeny (the "Neo-Harringtonians") were the focus of a summary in the Summer 1982 *Literature of Liberty*, p. 87-88.



*James Harrington*

## Locke, 'Property' & Natural Rights

Judith Richards, Lotte Mulligan, and  
John K. Graham

La Trobe University, Melbourne

"'Property' and 'People': Political Usages of  
Locke and Some Contemporaries." *Journal of  
the History of Ideas* 42 (Jan.–March 1981):  
29–51.

**T**he authors apply Quentin Skinner's and other new historians' methodology of the history of ideas to recover the linguistic context in which John Locke (1632–1704) began writing his *Two Treatises of Government*. Comparing Locke's use of *property* with his contemporaries', they conclude that his unique understanding of *property* led to a radically inclusive and democratic sense of who were *the people* endowed with full rights of participating in civil society.

Locke emerges as a far more radical theorist of universal popular rights than his fellow Whiggish republican authors of the Exclusion Crisis period (1679–1681): Algernon Sidney, James Tyrrell, and Henry Neville. Locke's radical commitment to universal natural rights and the "view that politics was indeed but a branch of moral philosophy" accounts for the relatively indifferent response to the *Two Treatises* in the years after their publication. The Tories' conservative and hostile silence is understandable. The Whigs, in turn, were embarrassed by Locke's more radical pressing of the very principles of property and rights that they nominally supported; Locke, however, "echoed too much of the language and principles of the other Whigs easily to be repudiated by them."

The Exclusion Crisis republicans reached back to the still living memory of the arguments over property, popular rights, and resistance to authority that were forged during the debates of the Civil War period (which involved such a mutual friend of Neville, Tyrrell, and Shaftesbury as the onetime Leveller, John Wildman). Locke and his three fellow republicans politically appealed to *property* as the anti-monarchical origin of civil society, but they understood *prop-*



*erty* in widely divergent ways. Political society arose to defend the people's right to their property and, therefore, property limited the sovereign's power and the people's obligation to obey edicts which endangered their property. "The concept of the natural rights of all, and the property rights of some, had been one way of arguing that political power came from the people. These writers turned again to the argument that property-ownership predated civil society as a means of describing the stake that men had in society."

Among these republicans Locke was the most radical in his widening the definition of *property*—like the Levellers—to mean property in each man's person (self-proprietorship) as well as land ownership.

Locke's widened definition of property as *self-proprietorship* tended to include *all* men in "the joint communal purposes of society—the protection of property." Locke unobtrusively implied that all men had a claim to an active political voice, not merely those who owned prop-

erty in the narrow sense of land ownership (and were thus economically independent in the Harringtonian sense).

Locke's distinctiveness from Sidney, Tyrrell, and Neville—who pragmatically restricted the franchise to those who met real estate qualifications—was “his consistent position that all men had a positive political interest through their

non-material possessions, their self-proprietty, and their natural rights.” Locke's moral absolutism in basing human rights in natural law led him to advance far beyond his fellow Whigs who generally preferred after 1688 a more narrow and status-quo interpretation of conventional property rights and a limited franchise.

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## Harrington vs. Hobbes on Politics

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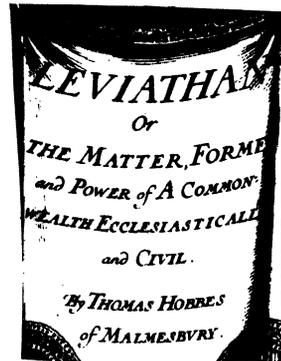
**James Cotton**

University of Newcastle upon Tyne

“James Harrington and Thomas Hobbes.”  
*Journal of the History of Ideas* 42 (July  
 –September 1981): 407–422.

**J**ames Harrington (1611–1677), English republican author of *Oceana* (1656), has been seen as borrowing heavily from Thomas Hobbes (1588–1679), but whatever Harrington borrowed he stamped with his own personality which distinguishes him from Hobbes on many issues. Harrington, in fact, criticized Hobbes for conflating certain classical distinctions (for example, that between a government of laws and of men) and for attempting to discover ultimate political principles outside of history. As a republican, Harrington believed in a government of laws, not men, for he believed that government should be limited by a covenant, as in the Roman Republic. Like Hobbes, Harrington maintained that governments founded on riches may have *power*; unlike Hobbes, however, he believed that only governments founded on virtue have *authority*.

Harrington differed from Hobbes also on religion and human nature. In arguing for a popular, public, civic religion, Harrington was arguing against the possibility of using the allegedly monarchic character of religion to support a monarchic politics. Hobbes was far more ambiguous on religion. Also, Hobbes saw



human nature as conflictful because of warring passions which were determined by *external objects*. By contrast, Harrington saw human nature engaged in a *moral* conflict between reason and passion, where reason ought to triumph. As a result, Harrington's perfect utopia, the commonwealth of *Oceana*, is one where reason triumphs in the lives of rulers and ruled.

Finally, Harrington's political methodology follows the model not of geometric science (like Hobbes), but of comparative human anatomy (as practiced by Harvey). Harrington engaged in a comparative political anatomy, which surveyed all the relevant types of government in order to ascertain an ideal commonwealth.

## Jeffersonian Optimism vs. Country Pessimism

Joyce Appleby

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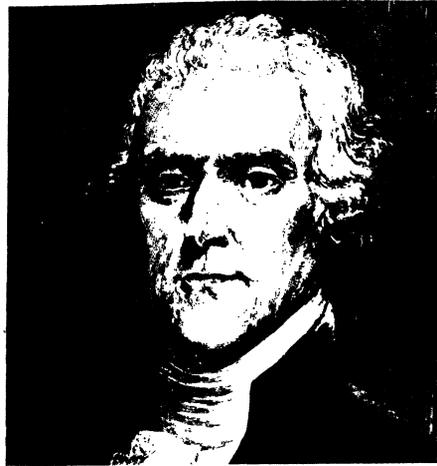
"What Is Still American in the Political Philosophy of Thomas Jefferson?" *William and Mary Quarterly* 39 (2) (April 1982): 287-309.

A great deal of scholarly effort has recently gone into construing the political philosophy of Thomas Jefferson and his followers as an American version of the English Country Party. This new interpretation rests on the foundation laid in Bernard Bailyn's *The Ideological Origins of the American Revolution*. For Bailyn, however, the Revolution was an event which transformed traditional British concepts in the American colonies and gave them a distinctly American cast. The scholarship of the last ten years has, on the other hand, tended to delay this Americanization of politics more than thirty years. Thus, the celebrated clashes between Alexander Hamilton and Jefferson have been reinterpreted as a transatlantic replay of the battle between the great Court politician Robert Walpole and his Country opponent, Henry St. John Bolingbroke. Some historians have even pushed the continuation of classical politics in America back to 1815. Reacting against this trend, Prof. Appleby's article stresses the numerous sharp divergences between Jeffersonian thought and the agrarian conservatism implicit in classical republican ("Country") principles.

Perhaps the most fundamental difference between Jefferson and the Country view lay in their divergent concepts of human nature. Country philosophy embraced the model of the eternal Adam with his penchant toward evil. Against this creature of dark passion, the forces of freedom and order had constantly to be on guard. The difficulty of guarding against him, of course, was that he existed in all of us. Jefferson, on the other hand, had adopted a conception of human nature that emphasized its benign potential.

Whereas traditional thinkers traced social evils back to wayward human pro-

pensities, Jefferson reversed the terms of this equation and ascribed man's lowly state to repressive institutions. The environment might create either vice or virtue. The innate qualities of man however held out great promise for the cause of virtue. The purpose of government was thus not to increase its power to check the power of the populace, but rather to ensure conditions for liberating man's self-actualizing capacities. Because of this positive view of human nature, Jefferson does not evidence the all-pervasive fear of the "mob" demonstrated by Country thinkers. As a result, he could write to Abigail Adams that his followers feared the ignorance of the



people less than the selfishness of their rulers.

Jefferson reversed the priorities implicit in the classical tradition on another basic political question. For him, the private had primacy over the public. Country philosophy had regarded the public arena as the locus where men rose above self-interest to serve the common good. Jefferson, on the contrary, wanted government to offer protection to the per-

sonal realm, so that men might freely exercise their beneficent faculties.

In addition, Jefferson did not share the classical fear of "luxury" and its corrosive effect on republican virtue. On the contrary, he extolled his nation's enormous potential for plenty. In his writings, he described the enlightenment which would result from a populace comprised of comfortable, well-fed landowners, contrasting them with impoverished, ignorant masses of many European countries.

Finally, Jefferson dismissed Country-minded distrust of the large republic. Far from considering expansion as a danger

to freedom, he encouraged it—provided that it was founded "not on conquest, but in principles of compact and equality." Jefferson's optimism led him to believe that an enduring republic was "built much on the enlargement of the resources of life, going hand in hand with the enlargement of territory, and the belief that men are disposed to live honestly, if the means of doing so are open to them." This ebullient expression of hope helps us to judge how far Jefferson the American had moved from the crabbed pessimism and distrust of the British Country tradition.

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## Rival Notions of Republicanism

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**John W. Malsberger**

Dept. of History, Muhlenberg College

"The Political Thought of Fisher Ames." *Journal of the Early Republic* 2 (Spring 1982): 1–20.

**F**isher Ames (1758–1808), a Federalist representative from Dedham, Massachusetts in the first four Congresses, is mistakenly viewed as a paranoid conservative zealot. Ames' vitriolic anti-populism was rather an expression of "his political ideology which more closely resembled seventeenth century classical republicanism than the definition of republicanism which emerged in America following the Revolution."

On several critical issues, including his pessimistic view of mankind's depraved nature, the chaotic condition of the pre-civil state of nature, and his insistence on a strong, centralized, and paternalistic government, Ames' political thinking differed from his chief enemies, the Jeffersonian Republicans. Growing increasingly pessimistic with the successes of Jefferson's version of populist republicanism, Ames feared for the survival of constitutional government. "In essence, then, Fisher Ames was a classical republican theorist attempt-

ing to deal with a political system which was no longer based on those ideals."

The post-Revolutionary period witnessed the subtle transformation of Ames' classical republican ideal of a "mixed constitution" made up of a balance of social groups or estates (monarchical, oligarchic, and popular) into a predominantly democratic separation of governmental powers. This shocked such classical republicans as Ames who feared the undisciplined people as a mobocracy and who insisted on the rule of "virtue" through a "natural aristocracy" and powerful, paternalistic government.

Believing in the idea that liberty could be secured only by such a vigilant central government, Ames was baffled by the contrary Jeffersonian republican ideology which believed that individual liberty grew as government declined. Ames' classical republicanism also differed from the Jeffersonian approval of multiple factions, an optimistic view of

human nature, and democratic populism. Republicanism as Ames understood it in the classical sense did indeed decline during the early national years

under the pressure of a more modern and pluralistic republicanism espoused by Jefferson and Madison.

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## *Charles A. Beard: Power vs. Authority*

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**John Patrick Diggins**

Department of History, University of California, Irvine

"Power and Authority in American History: The Case of Charles A. Beard and His Critics."

*American Historical Review* 86 (October 1981):  
701-730.

**R**eassessing Charles A. Beard involves understanding that his basic concern was the problem of authority and that he believed that legitimate government ought to be based on moral "ideas" rather than on class "interests." It was the divorce between power and authority that led Beard, in the *Economic Interpretation of the Constitution* (1913) and elsewhere, to criticize the framers of the Constitution and the historians who uncritically accepted its foundations.

Contemporary critics charge that Beard's *Economic Interpretation* reads into the 18th century a conflict between property and liberty that does not exist in the Constitution. However, the meaning of both these concepts changed between the Declaration (1776) and the Constitution (1789). Madison and Hamilton defined "property" less as a natural right than as a "present possession." "Liberty" had also shifted its meaning, no longer signifying the collective will of popular majorities, but rather something that needed to be safeguarded by the Constitution's mechanisms.

Beard was also charged with erring in interpreting the Constitution as a violation of the spirit of the Declaration of Independence. However, the meaning of "authority" had shifted from 1776 to 1787, from grounding rights on nature and contract to grounding the Constitution on power and interests.

The neo-Whigs criticized Beard for neglecting the concepts of virtue, inde-

pendence, and deference, upon which the 18th century based its defense of property. However, neither Madison nor Hamilton believed that the demands of property stimulate independence. These constitutional theorists rather believed that property brought one into a whole network of power relationships, and in this respect, Beard followed their lead.

Another charge against Beard is that he failed to understand that the Founders were acting on the basis of "ideas" rather than "interests." However, the authors of the *Federalist Papers* did not regard principles and ideals as controlling man's passions; rather, they asserted that ideas could not compel man's mind unless such ideas reflected the interests men were inclined to obey. Economic interests were primary in providing the motive for political obedience. Most of Beard's critics inferred that the Constitution's "framers were men of ideas because they cited the works of European political thinkers, and intellectual historians assume that they can overcome Beard's dualisms [between 'idea' and 'interest' or 'theory' and 'practice'] by employing the analytic methods of language philosophy—a dubious assumption that avoids the whole issue of causation." Professor Diggins charges J. G. A. Pocock (as a representative of this linguistic and contextualist school) with substituting linguistic determinism for Beard's alleged economic determinism and with confusing description, based on

semiotics and structuralism, for explanation and causation. He promises a full-er discussion of this issue in a forthcoming *History and Theory* article, "The Oyster and the Pearl: The Problem of Contextualism in Intellectual History."

Finally, Beard has been charged with an uncritical commitment to a theory of economic determinism, but this ignores the attention he devoted to the thoughts and lives of the individual Federalists and their opponents. It also ignores the sense in which Beard wanted to deny that

the Constitution had to be a necessary "stage" in America's history.

Ultimately, Beard believed that in attempting to disperse power, the framers also destroyed authority. He therefore assumed that the interests of those exercising authority must contradict the interests of those being ruled. It is this assumption that Prof. Diggins believes we need to question, for how can the Constitution have survived if American society is not based, in large part, on consensus?

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## *Marxist Historiography & the French Revolution*

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**Joseph I. Shulim**  
Brooklyn College, CUNY

"The Continuing Controversy over the Etiology and Nature of the French Revolution." *Canadian Journal of History* 16 (December 1981): 357-378.

**N**ew historiographical information requires us to objectively appraise the traditional Marxist interpretation of the etiology of the French Revolution. Marxist historians agree in viewing the causation of the Revolution as materialist: the *Manifesto* claims that the Revolution represented the growth of capitalism and the triumph of "bourgeoisie" since the *ancien régime's* "feudal relations of property became no longer compatible with the already developed (bourgeois) productive forces." The essential cause of the Revolution, in Marxist materialist terms, was the newly asserted power of bourgeois productive forces translating themselves into law and property. Marxists also claim that the Revolution was preceded during the century by an aristocratic reaction which reached its climax in 1787-1788, in what Mathiez called the "*revolte nobiliaire*." In other words, the Revolution that followed 1788 opened the way to untrammelled capitalism by changing the juridical and political su-

perstructure of France in favor of bourgeois class interest.

This Marxist interpretation is shown to be invalid by the research of the past several decades. Prof. Shulim presents in summary form the evidence and facts which, he claims, undermine the Marxist preconceived theory of dialectical materialism as a historical framework for the Revolution.

Economic evidence does not support any sudden change in the means of production and exchange in eighteenth-century France. Agricultural wealth predominated and there was no "Industrial Revolution" in whose wake some allegedly homogeneous bourgeois class came to power. Nor was there any homogeneous antagonist "social class" called the "nobility" which was defeated by the emergent bourgeois "class." The heterogeneous noble order had interlocking economic interests with their alleged "class" enemies. For both "classes" proprietary wealth was the stepping stone to

higher status and power. "There was, between most of the nobility and the proprietary sector of the middle classes, a continuity of investment forms and socio-economic values that made them, economically, a single group. In the relations of production they played a common role."

Likewise, recent historical studies debunk as exaggerated myth an alleged "Aristocratic Revolution" of 1787-1788. The nobles were not a single class, had many rivalries among their grades, and did not unite to prevent the rise of a middle class. On the contrary, the middle-class Third Estate found entry into the noble Second Estate relatively easy. "The social history of eighteenth-

century France thus reveals in general not an aristocratic reaction but rather the victory of wealth."

Shulim also critically assesses evidence of the lower classes and peasantry, a "feudal reaction," and the nature and role of the Enlightenment. He notes that the *philosophes* did not spring from a single class or social group and that the "consumers of the Enlightenment" came from every stratum of educated society. Finally, the author calls into question the alleged capitalist attitudes and motivations of the revolutionary and post-revolutionary legislators. Even some leading Marxist historians, he claims, now admit that the "bourgeoisie" did not mature by 1789.

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## Mill on Class and Ideology

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Eileen P. Sullivan

Department of Political Science, Columbia University

"A Note on the Importance of Class in the Political Theory of John Stuart Mill." *Political Theory* 9 (May 1981): 248-256.

The standard view of Mill, and of liberals generally, is that they assign the crucial historical role to ideas and ideology rather than to class interests. Sullivan argues that Mill always recognizes the crucial importance of class in historical interpretation and that over time he develops an increasingly sophisticated position on the relationship between class and ideology. The author supports her argument by analyzing Mill's articles on the liberal parties in France and England through the decade of the 1830s when he was the chief correspondent on French politics for the English radical press.

"Mill always regards a socially and economically powerful middle class as the necessary base for a successful liberal party. Over the course of his studies, Mill is forced to clarify his defini-

tion of this middle class and to recognize that the consciousness or ideology of the middle class does not always follow from its objective class position and interests. He is forced to conclude that there are two independent preconditions of liberal party success: a powerful middle class which is also aware of itself and of its interests."

Mill defines the middle class, unlike Marx, by the amount rather than the source of income. The liberal constituency possesses moderate wealth (whether industrial, landed, or commercial) as against both its class enemy, the wealthy ruling minority, and its potential class ally, the working class. In his early thought Mill imagined that ideology follows from class position, and he was accordingly more sanguine about a liberal political victory in France than in

England. The conservative wealthy minority, however, triumphed in France in 1830 contrary to Mill's analysis.

To explain the middle class' political victories in England as opposed to that same class' defeat in France, Mill revised his position. He now contended that "despite its important social and economic position, the French middle class is not sufficiently class conscious, is not sufficiently aware of itself as a separate

group with distinct interests." By contrast, Mill traces the success of the English liberals to both the socioeconomic class power and the correct understanding (ideology) of their middle class constituency. Class ideology does not necessarily follow from class position, but depends also on the political traditions and institutions within which a class develops.

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## Mill on a Principled Political Party

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**Bruce L. Kinzer**  
McMaster University

"J.S. Mill and the Problem of Party." *Journal of British Studies* 21 (Fall 1981): 106-122.

**I**t is misleading to regard John Stuart Mill's (1806-1873) attitude to political party as simply negative either because of his scanty references to party in his *Representative Government* or because of some of his hostile comments. In reality, Mill's hostility was not directed against the principle of party but rather against the existing unprincipled party system in England. He offered a moral ideal of party and dedicated his intellectual and political activity to this moral ideal's aim: "the improvement and elevation of the individual's aesthetic, ethical, and mental faculties. For Mill, all thought and public activity, whether of a philosophical, economic, or political character, was to be directed towards the single end of making man better than he was by facilitating the full development of his potentialities."

Joseph Hamburger, in *Intellectuals in Politics: John Stuart Mill and the Philosophical Radicals* (1965), has discussed the centrality of party to Mill's political activity during the 1830s when he tried unsuccessfully to form a genuine Radical Party which would abolish aristocratic government and work for the democratization of British institutions and society. Mill held the idealized view that party

should be the organized political expression of principled ideological commitment. As he argued in his important 1839 essay, "Reorganization of the Reform Party," there should be two principled and antagonistic parties—a Conservative Party and a radicalized Liberal Party—which would function dialectically to best advance the respective claims of tradition and progress.

British national politics, involving Whigs and Tories, during the quarter-century after 1840 did not live up to Mill's ideal of principled parties. Mill was disillusioned by the pragmatic and unprincipled politics of Palmerton's ascendancy. Finally, in 1865, Mill found an opportunity to create an "advanced Liberalism" by holding high the ideal of an intellectually principled party when he entered parliament as a highly independent member for Westminster. With Palmerstone's death, Mill held out the hope that Gladstone might be the rallying figure to create and lead "an advanced Liberal Party" dedicated to democracy and reform. But Mill's commitment was not to the *de facto* Liberal Party or its leader; it was to principle. He saw the large electoral victory of the Liberals in 1868 as just a "seeming vic-

tory" since Gladstone did not appoint to prominent positions any advanced Liberals.

Mill's ideal of a reform party subtly shifted, because of political circumstances, from 1839 to the late 1860s. His earlier "Reorganization of the Reform Party," had claimed the motto of a Radical politician should be "Government by means of the middle class for the working

classes." Seeking a Liberal Party alliance to redress the practical grievances of the working classes in the 1860s, Mill now sought "government by the middle and working classes for the nation." Meaningful political participation of the working classes would provide civic education and competence for their untested human potential.

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## *Tocqueville: On Prisons & Modern Despotism*

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**Roger Boesche**  
Occidental College

"The Prison: Tocqueville's Model for Despotism."  
*The Western Political Quarterly* 33 (December 1980): 550-563.

**A**lexis de Tocqueville's (1805-1859) idea of political despotism becomes clearer when we compare it to Tocqueville's (and Beaumont's) long ignored writings on Pennsylvania's prison system, a system he labeled "the most complete despotism."

The ostensible reason that Tocqueville and Beaumont voyaged to the United States in 1831 was to study prisons. Upon returning to France, Tocqueville undertook *Democracy in America* only after he and Beaumont had written a book detailing prison reforms in the United States: *On the Penitentiary System of the United States and Its Applications in France*. Few critics have related this book on prisons to Tocqueville's political thinking, yet it might have as much to say as *Democracy in America* and the *Old Regime*, both of which works harbored the fear that modern democracy contains a tendency to a qualitatively and historically new kind of despotism, a despotism for which the Pennsylvania prison might serve as a prototype.

"Early in his political career, Tocqueville emerged as a sometimes passionate advocate of the prison reforms enacted by the Quakers in Pennsylvania in the 1820s and 1830s. Reformers dur-

ing these decades in the United States attempted to solve the problems of insanity, poverty, and crime through incarceration—in the asylum, the poorhouse, and the prison—isolating the recalcitrant and teaching industrial discipline to the able-bodied. The Pennsylvania prison system, embraced both by Tocqueville and the Quaker reformers, astonishes our twentieth century sensibilities, an astonishment mitigated only slightly when we grasp that these reformers genuinely believe that a thorough going rehabilitation and reform of many (certainly not all) prisoners was possible. The pivot on which this reform of the prisoners turned was thought to lie, strange as it seems, in the architecture of the prison, because the architecture alone made possible the one indispensable ingredient: the absolute isolation of the prisoner. The Quaker theory of prison reform can be summarized quite quickly: each prisoner was to be placed in solitary confinement, each would then experience tremendous anxiety and remorse, each would attempt to divert thoughts of despair by hard work, eventually each prisoner's anxiety would lead him to welcome the visits and conversation of priests and outstanding citizens, and finally the sheer force of iso-

lation and anxiety would lead the prisoner to alter his ideas, habits and instincts—and the rehabilitation would be complete.”

The prison's predominant characteristics were a rigid isolation of prisoners, strict equality, productive labor, and the complete privatization of life. Tocqueville suggests that by using the terror created by this system, especially the despair generated by solitary confinement, the prison often succeeded in reshaping the

prisoner's mind and reforming his very “instincts.” In a strikingly parallel fashion, Tocqueville chooses the same characteristics to depict the emerging political despotism. The new despotism, too, will rely on isolation, equality, an obsession with the private production and consumption of goods, the eclipse of public life, and the loss of a meaningful future—all of which will render men passive, dominated by a centralized government and a suffocating majority opinion.

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## Harriet Martineau's Social Thought

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Paul L. Riedesel

“Who Was Harriet Martineau?” *Journal of the History of Sociology* 3 (Spring 1981): 63–78.

**A**t one time more popular than Charles Dickens, Harriet Martineau (1802–1876) deserves reconsideration as possibly the first woman sociologist whose social analysis of institutions resembled that of the recognized precursors of modern sociology. Riedesel gives an overview of Martineau's life and writings; argues that key elements of sociological perspective (naturalism, empiricism, and objectivity) were evident in her thinking; and concludes by outlining the specific sociological hypothesis found in her work.

Born into a Unitarian manufacturer's family in Norwich, England (a provincial center of Dissent), Harriet Martineau imbibed the Enlightenment faith in empiricism, and despite deafness and a scanty education developed her writing talents. She judged Unitarian Christianity as too metaphysical and looked to natural science for understanding. In 1831, she embarked upon a series of didactic stories to teach the principles of economics and won a huge commercial success with her *Illustrations of Political Economy* (a popularization of James Mill's *Elements of Political Economy*). She next turned her impressions of a two-year visit to America (1834–1836), which

included conversations with Emerson and Channing, into the popular three volume *Society in America*. Partly recovering from ill health in 1844 through mesmerism, she turned out a spate of writings which continued after she became a recluse in the 1850s. In 1851 she began her well-received two-volume translation and abridgement of Auguste Comte's *Cours de Philosophie Positive*. Her *Positive Philosophy* (1853) was a tribute to Comte's “scientific” rather than “metaphysical” approach to the unification of knowledge.

Martineau's *Positive Philosophy*, *Society in America*, and *Political Economy* displayed naturalism, empiricism, and objectivity—three components of a sociological perspective. The world she inhabited was truly “disenchanted,” a naturalistic order governed by impersonal laws which fashioned institutions. She fused together Unitarian necessitarian doctrine with David Hartley's (1705–1757) early version of mechanistic behaviorism, which she learned from Joseph Priestley's edition of Hartley. Empiricism as opposed to idealism seemed to Martineau a sounder basis for science and progress in the social sciences. Finally, her *Society in America*

evidences a sustained effort at objectivity in judging a foreign country by non-arbitrary standards.

Among the elements and themes of applied sociological analysis found in Martineau's works are: community, cul-

tural integrity, structural sources of social action, and stratification. In regard to this last element, she rejected Marx's ridicule of orthodox political economy's view of society and social classes. <sup>[4]</sup>

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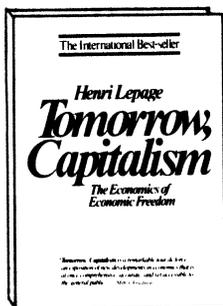
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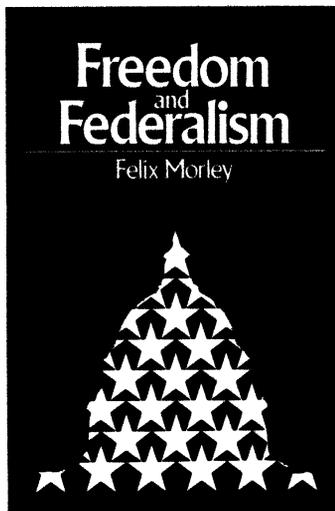
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