Leonard Liggio lecture 2016: The Classical Liberal Tradition of Sound Money

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Let me welcome you all to the capital of Latin America. And when I say capital, I mean that much of the financial wealth of Latin America is held with banks and fund managers across the street, here in Miami. And therein lies a lesson in the results of unsound money.

But seriously, I am very pleased to be this year's Leonard Liggio lecturer. I thank Atlas and especially Brad Lips and Alex Chafuen for the honor.

I knew Leonard Liggio for 40 years. I first met him in the fall of 1974 at the "Libertarian Scholars' Conference" in NYC. I last spoke to him on the phone in 2014, when he was ill but still hopeful of recovering and resuming his travels to conferences on behalf of Atlas.

I want to tell one story about Leonard before I turn to my topic. While I was in college, I somehow became responsible for organizing an extra-curricular evening lecture that Leonard was to give on our campus. The topic was the historical background to the civil war then raging in Angola. The lecture was scheduled to last one hour. Leonard had no notes with him. But that's not the best part. As we walked to the lecture hall, Leonard turned and asked me, "Should I start the history around 1400, or 1900?" As though I knew something about Angola's history. I improvised a reply: "Why don't you start around 1400, and try to get to 1900 within the first 20 minutes, then bring it up to the present?" He said okay, and proceeded to do just that.

I want to talk this evening about the tradition of classical liberal thought on sound money. Don't worry, I won't start around 1400. That's too late. I will start around 1350. I do, however, have notes.

How do the principles of classical liberalism apply to money? Pretty much as they do to wheat. They call for allowing users and suppliers of money to interact in a market system free of state *privileges*, free of *legal restrictions* other than those against fraud and theft, and free of discretionary *regulatory* controls.

But money is more important than wheat, and I don't say that in a spirit of gluten intolerance. Some of you may recall the Simpsons episode where Homer drops a peanut that disappears between the cushions of his sofa. Fishing for it, he finds a $20 bill. "Aw, twenty dollars?" he says, "I wanted a peanut." Homer's brain immediately tells him: "Twenty dollars can buy many peanuts." "Explain how!" Homer demands. His brain answers: "Money can be exchanged for goods and services."

As the commonly accepted medium of exchange, money is the good on one side of every transaction. State disruptions to the supply of money, or to the demand for money, boggle not just one market but the entire economy. Historically, one of the oldest abridgements of economic freedom is the state's monopoly over the mint. It goes back to ancient times, because as soon as merchants developed the technology of coinage, mint monopoly could provide a major source of revenue. Because state abuse of coinage is so ancient, it was a leading-edge issue on which the ideas of economic liberalism began to form.

The scope for private institutions to supply money grew during the middle ages as commercial banks provided a *better* money than the royal mints. But today it is heavily circumscribed by laws and regulations. You and I are restricted in how we can spend and transfer the money we own. The little freedom that remains is under attack. For example, the Harvard economist Kenneth Rogoff has a new book titled *The Curse of Cash*, in which he calls for abolition of $20 and $100 bills because — hold on to your seat — criminals use them. Not to be outdone, Prof. Narayan Kocherlakota, who stepped down last year as president of the Federal Reserve Bank of Minneapolis, published an opinion piece earlier this month calling for the federal government to "abolish currency and move completely to electronic cash." There are similar moves afoot in Europe.

And those are just the intellectuals. The actual regulators at the U.S. Treasury Department's Financial Crimes Enforcement Network are scarier still. They not only abridge the financial privacy rights of Americans, they pressure governments around the world to adopt the intrusive U.S. "know your customer" rules if they want to do business with any U.S. banks.

I was fortunate that Leonard Liggio helped to direct my reading in the history of money, and the history of liberalism as it relates to money. In particular he drew my attention to work by the early French scholastic writer Nicole Oresme, from the 1350s, and to the works of the 20th century economic historian Raymond de Roover. (Has anyone else here experienced the majesty that is de Roover's article "What is Dry Exchange?") In an autobiographical essay, Leonard recalled having talked for "hours with de Roover over beer" after a meeting of the monthly Mises circle in New York at which de Roover had come to give a presentation.

De Roover, by the way, famously debunked the "fairy tale" (his words) that the Christian scholars of the middle ages, the Scholastics, subscribed to a cost-of-production theory of the "just price." Instead, for most, the "just price" was simply the prevailing market price, absent collusion or emergency. (Since Alex Chafuen is here, I thought I'd throw in a good word for the Scholastics.)

Some of the earliest Christian thinkers up to 1225, however, took an actively hostile view toward money. One reads that the Franciscan and Dominican religious orders, founded 1209 and 1216, initially refused even to handle coins. For them, money was either sinful as such, or at least posed a temptation. Then Aristotle's *Nicomachean Ethics* was rediscovered and disseminated across Europe. It introduced into Scholastic thought the idea that money is so useful that it actually promotes society's well-being. But Aristotle's writings on money were highly equivocal. The philosopher, as the Scholastics called him, had declared on the one hand that money had naturally arisen as a convenient measure of value, but on the other hand that it "exists not by nature but by law."

Thomas Aquinas didn't have all that much to say about money. The key early Scholastic work on money was by Nicole (or Nicholas) Oresme (*c*.1320–82), a French bishop, who drew on his teacher Jean Buridan. F.A. Hayek once commented that "Italy of the sixteenth century has been called the country of the worst money and the best monetary theory." France of the 14th century is a close contender. Buridan and Oresme lived through, and were outraged by, a massive debasement of the French coinage by King Philip the Fair. Or perhaps we should call him Philip the Unfair.

Oresme's great work, published around 1358, has been called "the first text dedicated solely to money and particularly to the alteration of coins." The monograph, in Latin, has a long Latin title that means, "Treatise on the origin, nature, law, and alteration of monies." It also goes by a shorter title: *De moneta*, "On money." In a recent account, one scholar (Fabian Wittreck 2016) comments that Oresme wrote it not in a mood of serene scholarly detachment, but in a "desperate attempt to influence the monetary policy of his prince."

A few years back (2000) I had the opportunity to edit a three-volume collection of historical writings titled *The History of Gold and Silver*. I naturally led off volume 1 with an English translation of Oresme's *De Moneta*.

Here is Oresme's argument in a nutshell: Coins held by ordinary people are their own property, not the king's property. The people are defrauded when the state mint dishonestly debases the coins.[1] Fraud is unjust. Hence, if the sovereign runs the mint, the sovereign is duty-bound not to debase. If he debases, he acts unjustly. He cheats the people.

This was radical talk. Oresme's work was a landmark in the development of the view that the sovereign and the state officials are not above the law, but answerable to it. The actions of state agents are illegitimate if they violate the sacred rights of the people.

Oresme and his followers were not modern libertarians, of course. They accepted the sovereign's monopoly in coin production that they lived under. Oresme even commented that fraud would be a danger if unofficial parties could make coins. (This reminds me of Milton Friedman's one-time view, which he later revised, that fraud would be a danger if unofficial parties could issue banknotes. I will return to this later.) He did not consider whether competition among mints — not entirely unknown in Europe at the time — might actually be more effective than sovereign control of a monopoly mint, as a means for restraining fraudulent practices. Today we actually have numismatic evidence that it was. In the gold and silver rushes of the American West, private mints were *more* scrupulous. Their coins were more precisely minted than official coins. Their business more keenly depended on it.

Oresme had great influence, particularly on the important German scholastic Gabriel Biel, who wrote in the late 1400s, and on the outstanding Spanish scholastic Juan de Mariana, who wrote in the early 1600s. Mariana is of course more famous of the two today because he has

[1] Technical aside: there are three ways to debase: [1] remint coins with a lower percentage silver content, using the same coin dies and giving them the same face value; [2] reduce the coins' weight without reducing their face value, and [3] "cry up" the currency, i.e. raise the face value of existing coins with no change in content.

an Atlas-linked institute named after him, founded by Gabriel Calzada and now directed by Juan Ramon Rallo. As far as I am aware, there is no Gabriel Biel Institute. It's a pity.

Biel observed that a sovereign who dishonestly reduces the silver content of coins when minting or re-minting them, without any necessity, but only to make a profit, acts no differently from a low-life individual who alters coins by filing or sweating them. Such a sovereign commits a mortal sin. He is a cheat; he bears false witness. The alteration is an act of tyranny, since it is an unjust exaction on the people.

Juan de Mariana extended Oresme's analysis in his work *De Monetae Mutatione* (*On the Alteration of Money*), published a few years after the debasement of small-denomination copper coins by King Philip III of Spain in 1602. In the Castillian Spanish of the day, the copper coins were called *vellones*, which also meant "fleeces" from sheep — appropriately, because the coins quickly became a device by which the king *fleeced* the public.

Mariana distinguished the just king from the tyrant this way: "The tyrant is he who tramples everything underfoot and believes that everything belongs to him." The just king, by contrast, respects the property rights of the people. As Mariana charmingly put it, a just king "limits his covetousness within the terms of reason and justice." It follows that the just king may not debase the coinage without the consent of the people. Nor may he tax them, nor impose monopolies, without their consent.

To drive the point home, Mariana reasonably asked, "Look: would it be allowed for a prince to break into his subjects' granaries, take half of the grain stored there for himself, and by way of compensation allow the owners to sell the remainder at the same price as the original whole?" And he answers, "I do not think that there would be anyone so preposterous as to condone such an act. But that is precisely what happened with the old copper coins."

This was *very* radical talk. Verging on treason, even.

A historian (Decock 2016) relates that Mariana "was held in custody in Madrid and Rome, and was urged to modify offensive passages in his treatise. In the meantime, Pope Paul V put the first edition of *De Monetae Mutatione* (1609) on the Spanish index of prohibited books. Moreover, state officials removed almost all extant copies from circulation."

Mariana referred to debasements "tricks," and warned that they "are geared towards one and the same unlawful end, namely to oppress the people with new burdens and to amass money." In 1776, Adam Smith likewise referred to debasement as a "juggling trick," whereby a government pretends to repay its debts in coin but actually defaults on them by paying less in precious metal than is owed.[2]

Inspired by writers like these, classical liberalism coalesced around opposition to rule by unconstrained authorities. Or, to put it positively, liberal thinkers learned to uphold individual liberty and private property rights, including freedom of contract, under the rule of law.

From the late Scholastics, let's now fast-forward 150 years to the Scottish Enlightenment, where the two most important defenders of monetary liberalism were David Hume and Adam Smith. The anti-liberal or Mercantilist writers of the day advised the sovereign to have the nation perpetually run a so-called balance of trade "surplus" — sell more exports, buy fewer imports — in order to perpetually accumulate silver and gold. Hume demonstrated — through one of the first uses of explicit thought experiments in economics — that this mercantilist advice was foolishness. The "price-specie flow mechanism" spelled out by Hume shows how the quantity of silver or gold in an economy regulates itself. When the domestic public has less money than it

[2] On the Spanish scholastics more generally, see Marjorie Grice-Hutchinson, *Early Economic Thought in Spain, 1177–1740* (1978), and, of course Alejandro Chafuen, *Faith and Liberty: The Economic Thought of the Late Scholastics* (2003).

wants, they soon enough get more by siphoning off some of the money that flows in through sales of goods to the rest of the world, accumulating it rather than spending it off by buying imports, until the public builds up its money balances to the desired size. Conversely, money balances in excess of the desired quantity flow out, through purchases of goods and services that are more highly desired at the margin. The national or regional stock of metallic money thus regulates itself through market forces. Imports quotas or taxes, and exports subsidies, are completely unneeded to keep the economy fully stocked with metallic money.

Adam Smith extended Hume's argument: self-regulation *also* governs the regional quantity of a "mixed currency" consisting of silver or gold coins *plus* redeemable banknotes issued by competing commercial banks, the system that surrounded him in Scotland. He saw other benefits in the Scottish system of "free banking." First, the voluntary use of redeemable notes and transferable deposits offered by competing banks, as a substitute for precious metal coins, enhanced the wealth of the nation, allowing the export of some of the coin stock to finance the import of productive machines. Smith argued that "the greater part" of the gold and silver sent abroad will "almost unavoidabl[y]" be used to "purchase an additional stock of materials, tools, and provisions" that is "destined for the employment of industry." Banknotes thus enabled the nation to exchange much of its "dead stock" of gold and silver for productive capital goods.

Smith saw another major benefit of free banking: having note-issue decentralized provided diversification against risk of default by a currency issuer. If one bank out of 20 defaults, 5 percent of the public suffers. By contrast, if a monopoly issuer like the Bank of England defaults, everyone suffers, and the metallic standard is suspended for everyone. As Smith wrote in *The Wealth of Nations*:

> The late multiplication of banking companies in both parts of the United Kingdom, an event by which many people have been much alarmed, instead of diminishing, increases the security of the public. ... 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 public.

Already in 1776, Smith had identified the remedy to “too big to fail” banks: allow free entry and grant no privileges. And a remedy to the problem of the untrustworthiness of central banks: have money issued by *many* firms *bound by contract to redeem*, not by one body that is above the law.

Finally, Smith saw advantages in free competition among banks in lending: better terms for their customers. He concluded:

> 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 public, the freer and more general the competition, it will always be the more so.

One of Hume’s and Smith’s prominent followers, the English classical economist Nassau Senior, in an 1827 lecture rightly ridiculed:

> that extraordinary monument of human absurdity, the Mercantile Theory,—or, in other words, the opinion that wealth consists of gold and silver, and may be indefinitely increased by forcing their importation, and

> preventing their exportation: a theory which has occasioned, and still occasions, more vice, misery, and war, than all other errors put together.

On this side of the Atlantic, we know that founding father Alexander Hamilton — he of the $10 bill and the smash Broadway hit — read *The Wealth of Nations*. And yet he promoted monopoly privileges for the Bank of the United States in 1791. He was unfortunately a mercantilist in banking policy as well as in trade policy. Although Ben Bernanke has written that Hamilton "was without doubt the best and most foresighted economic policymaker in U.S. history," I reply, "Not!" Hamilton had an essentially mercantilist agenda, and failed to embrace the better and more foresighted liberal policies that Smith laid before him.

Thomas Jefferson, Hamilton's great opponent on economic policy, also read Adam Smith, but in his own way also failed to embrace Smith's teachings. While T.J. rightly opposed Hamilton's single federally privileged nationwide bank of issue, he favored *zero* nationwide banks of issue, not many. He was even suspicious of state-government-chartered banks of issue.

Smith's work on banking did, however, come to inspire defenders of "free banking" around the world in the debates that surrounded the creation of national central banks in the 19th and 20th centuries. (A classic account of these debates is Vera Smith's *The Rationale of Central Banking*, published 1936. It is available at the Liberty Fund's website.) In Britain, there was what I call a "Free Banking School" in the 1825–50 period who argued for removing rather than enhancing the Bank of England's monopoly privileges. Smith's followers in the FBS strengthened his arguments for free trade in banking and for viewing bank-issued money as self-regulating. On the continent, J.B. Say and others recommended free banking over central banking.

Here in the United States classical liberals like William Leggett and Richard Hildreth in the 1830s argued for free entry into banking and note-issue rather than the restrictive chartering system in place. In Latin American countries, periods of liberal constitutions during the 19th century often brought free banking reforms, enacted as an integral part of liberal economic policy. (By the way, a new volume on Chile's favorable experience with free banking will soon be published by scholars at the Universidad de Desarollo.) All these advocates saw that free banking is the policy ideal that results from applying the norms of classical liberalism to money and banking.

Other leading classical liberals of the 19th century, I regret to note, failed to consistently apply their principles to money. David Ricardo favored nationalization of coinage and banknote issue, and the forced substitution of redeemable paper notes for coins in all but the largest payments. Richard Cobden, the heroic leader of the movement against the Corn Law tariffs, supported the nationalization of banknotes.

Whereas Smith and Hume largely shied away from analyzing whether the sovereign's policy was unjust or sinful, and asked mainly whether it was prudent, two of their followers were quite passionate: Thomas Paine in the 1780s and William Cobbett in the 1810s.

Paine took up the theme of bane of irredeemable government-issued paper against the blessing of gold and gold-redeemable banknotes. The occasion was a threat, soon after the Revolutionary War ended, that the Commonwealth of Pennsylvania would issue its own irredeemable paper notes. Like Adam Smith, Paine recognized the benefits of redeemable commercial banknotes. But he warned:

> But when an assembly undertake to issue paper as money, the whole system of safety and certainty is overturned, and property set afloat. Paper

> notes given and taken between individuals as a promise of payment is one thing, but paper issued by an assembly as money is another thing. It is like putting an apparition in the place of a man; it vanishes with looking at it, and nothing remains but the air.

Like Oreseme and Mariana before him, Paine denounced the injustice of legal tenders laws that compel creditors to accept payment in legally overvalued money worth a fraction in the market of the money repayment actually contracted for. He declared:

> As to the assumed authority of any assembly in making paper money, or paper of any kind, a legal tender, or in other language, a compulsive payment, it is a most presumptuous attempt at arbitrary power. There can be no such power in a republican government: the people have no freedom, and property no security where this practice can be acted. … If anything had or could have a value equal to gold and silver, it would require no tender law; and if it had not that value it ought not to have such a law; and, therefore, all tender laws are tyrannical and unjust and calculated to support fraud and oppression.

I have been fortunate in my career to have a second mentor besides Leonard, namely Walter Grinder, who worked with Leonard for many years at the Institute for Humane Studies. When I told Walter a few weeks ago what the theme of this talk would be, he urged me to include the English writer William Cobbett among the liberal heroes on the money question. Cobbett's most famous work on money was *Paper against Gold*, first published in 1810 during a period in which the Bank of England had stopped redeeming its notes in gold or silver. (Liberty Fund now carries *Paper against Gold* (1815 edition) in its Online Library of Liberty.)

Like Paine, Cobbett was passionate about the injustice of what he called “that dreadful curse, a paper-money not convertible into gold and silver.” He roundly condemned the hypocrisy of Parliamentary defenders of the Bank’s continued breach of contract: “You tell us that the public like Bank notes as well as guineas [gold coins]. But, with these assertions upon your lips, you pass a *law* to protect the Bank against the demands of that public; you pass a law to *compel* that public to receive paper at the Bank, instead of that gold, which you say they like no better than that paper.”

One of the best pieces of advice that Walter Grinder gave me came 40 years ago, when I had to write a paper for a college course in U.S. intellectual history, he recommended that I look into the writings of William Leggett, the most free-market thinker of the Jacksonian Era. It was in Leggett’s work that I first saw a reference to the experience of free banking in Scotland, which became the subject of my dissertation and first book. I’m still milking the topic. So I’d say Walter’s tip paid off handsomely. (I also edited a collection of Leggett’s writings for Liberty Fund, also now online.)

Leggett, a journalist in New York City in the 1830s, was a key intellectual mover behind the so-called “Free Banking” laws adopted in various states. So-called, because they did not institute anything close to laissez-faire in banking, although they did open up and regularize the process of obtaining incorporation for banks. For Leggett, the injustice of restricting entry into banknote issuing followed from the principle that any individual “has a natural right to give his promise to pay a certain sum on a piece of paper, and, subscribing it with his name, to pass it for what those with whom he deals may be willing to receive it.”

Leggett’s ideal was the complete separation of government from involvement with banking. He opposed both government sponsorship of banks and, unlike some hard-money

Jacksonians, equally opposed any legislative ban on privately issued banknotes, writing that: “an exclusive metallick currency could only be instituted and maintained by the force of arbitrary government edicts, totally contrary to the first principles of natural justice.”

Competition among banks will ensure that the public receives whatever security against fraud it demands: “Let existing banks be subject to unrestricted competition, and then the banking associations, whether corporate or voluntary, that give the public the largest securities, and conduct their affairs with the wisest economy, will meet with the greatest success.” All that governments need to do is to “repeal those enactments which forbid the free use of capital and credit.” In his endorsement of full laissez-faire in the provision of bank money, Leggett went beyond Adam Smith, who had endorsed a ban on small notes and a ban on contractual clauses that gave banks the option to delay redemption on banknotes (for a penalty).

When restriction of the right of note issue was defended by analogy to the federal government’s constitutional power of coinage, Leggett was led by the logic of free trade to stand the argument on its head: “we have our doubts . . . whether it would not be better to leave coinage as well as banking, entirely to the laws of trade.”

Let’s skip ahead one more time. In the 20th century, the Austrian economist Ludwig von Mises reformulated the case for free banking with new analytical rigor in his great work *The Theory of Money and Credit* (1912). Friedrich Hayek made somewhat ambivalent cases for gold and free banking earlier in his career (in his 1937 book *Monetary Nationalism and International Stability*), but in the 1970s called forcefully for *Choice in Currency* and then *The Denationalisation of Money*.

Mises and Hayek were of course founding members of the MPS. Many other members, led by Milton Friedman, had made peace with central banking and fiat money during the 1940s through the 1970s. I'm told that debates over the gold standard versus rule-bound fiat money raged for so many years within the society, without resolution, that the topic has been deliberately omitted from the program since the 1980s.

Leonard Liggio described Milton Friedman's early position in this way when he wrote a piece summarizing the monetary debate at the 1978 MPS meetings: "Friedman said … that he believed government intervention in money was inevitable, and that therefore, the proper role of an economist was to advocate sensible interventions. He … advocated a constitutional amendment which would establish the rules that the monetary authority should follow. Friedman insisted that 'We are doomed' if we believe that de-statizing money is the only answer." Leonard's narrative continues: "F.A. Hayek then rose from the audience … He noted that the gold standard historically was the only discipline on governments. He reaffirmed his own opposition to all monopoly on money and to all government control of money. He presented what he calls his revolutionary program — monetary competition in each country after denationalization or destatization of money. The private issue of money, he argued, is the only answer."

It should be noted that Friedman moved toward Hayek's denationalization direction in the 1980s. I personally became aware of this change of outlook in 1983. In that year I published a piece in the *Cato Journal* which, in one passage, criticized Friedman's 1960 book *A Program for Monetary Stability*, and his 1962 *Capitalism and Freedom*, where he endorsed government monopoly of currency (on the grounds that private currency is inherently fraud-prone) and called for certain bank regulations to make control of the monetary aggregates easier for the Fed. Professor Friedman kindly sent me a note about that passage, telling me that our views were not as different as I thought. In a 1984 piece, he called for freezing the monetary liabilities of the central bank, shutting down the central bank's monetary policy committee, and allowing private competition in currency issue to satisfy any growth in the public's demand for currency.

What had changed Friedman's mind? Evidence. The post-1962 research on free banking by Hugh Rockoff and others had persuaded him that inherent fraud was not a problem with private note-issue, while his own frustration in getting the Fed to adopt a rule (interpreted in the light of public choice arguments) had convinced him that a central bank would wriggle around any rule imposed on it so long as it continued to exist. In a 1986 piece co-authored with Anna Schwartz, he was ready to give a more classical liberal answer to the question posed in the piece's title: "Has Government Any Role in Money?"

This is the question I want to leave you with: If we want to enlarge monetary freedom, and limit the government's role in the monetary system in the interest of sounder money, what's the best way for us to do that?