



Monetary Standards and the US Constitution

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Shadow Open Market Committee
March 25, 2011

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With the arrival of Representative Ron Paul as Chairman of the House Committee on Banking, the interest in considering a meaningful monetary standard for the United States has presumably increased by a substantial amount. It is important, then, to consider whether the Gold Standard, which Rep. Paul has championed over many years, is itself the best available monetary standard to adopt as a guard against inflation (and deflation).

Anyone who reads Article I, Sections 8 and 10, of the Constitution of the United States will see that the authors of that document intended that the United States should have a monetary system based on a metallic standard: a gold, or silver, or bimetallic standard—as it did for many years.¹ The historical movement away from such an arrangement—which involved Greenback issues during the Civil War, Supreme Court decisions afterward, Roosevelt’s nationalization of gold in the 1930s, and Nixon’s abandonment of the \$35 per ounce price for central bankers in 1971—is quite interesting but is not the topic of the present discussion. Instead, I wish to argue, *not* that we should return to a metallic standard, but rather that we could do much better than that while recreating the essence of the Constitution’s instructions within the context of today’s institutional and technological realities.

It is important to begin by recognizing that the provisions of the Constitution were basically designed to prevent major ongoing changes in the price level. Given the absence in the 1700s of publicly available data on comprehensive price indices—indeed, the absence even of any form of rapid communication among hypothetical statistical offices in different cities—the specification of a fixed metallic standard was the only means known to the authors for providing a degree of price level stability. In other words, the Constitution’s authors believed that a gold (or silver or bimetallic) standard was the most effective device for maintaining the purchasing power of money, thereby preventing inflations or deflations that would be unfair to either creditors or debtors and disruptive for the society at large. In this regard, it seems clear that the “value” specified by Article I, Section 8, was intended to be adjusted *very* infrequently, *if ever*; this was evidently implied by the appearance of the expressions “to coin money” and “regulate the value thereof” in the *same sentence* as the one that pertains to establishment of standards for weights and measures. Given today’s technology, however, a much better measure of the value of money is provided by various broad price indexes, such as the CPI. These relate to movements in the money price of their implied bundles, so their inverses are alternative measures of the value of money. Then near-constancy of the value of money could be provided in a manner that is slightly different from, and superior to, the gold standard.

¹ The document states in Article I that “The Congress shall have power ... to coin money, regulate the value thereof, and of foreign coin, and fix the standard of weights and measures” (Section 8) and that “No state shall coin money; emit bills of credit; make any thing but gold and silver coin a tender in payment of debts” (Section 10). The first of these two passages also includes the power “to borrow money on the credit of the United States” but that is a fiscal, not a monetary, provision.

Practically speaking, what the gold standard amounts to is providing two-way convertibility (at a fixed rate) between gold and the economy's basic medium of exchange—its money.² For example, prior to the breakdown during the Great Depression of the 1930s, bank notes were convertible into Federal Reserve notes and the latter were convertible into gold at 20.67 dollars per ounce. (Before 1914 the intermediate step was not present, of course.) So this system promised that paper dollars would retain their purchasing power in terms of the amount of gold that they would purchase. But that is not the ultimate objective, which is that dollars retain their purchasing power in terms of goods and services in general. Gold may retain its general purchasing power to a greater extent than any other single commodity, but is still rather poor in that respect.

Today, with our current capacity for information collection and dissemination, it would be possible for the Fed—or some other official agency—to use the same basic approach, namely, to stand ready to buy and sell legal claims at a given price. But instead of claims to gold, it could be a specified broadly-defined bundle of goods and services, as discussed above. Indeed, this bundle could be one that matches the goods and services that are referred to by the Consumer Price Index (or some other broadly-defined index, such as the one currently preferred by the Fed). Doing this would stabilize the money price of the broad bundle, i.e., would stabilize the general price level (under the chosen definition of the latter).

The main problem with the foregoing scheme is that it would be impractical and costly for the Fed or any agency to keep in storage all the goods (and services?!) needed to be able to fulfill the promise to sell the standard bundle containing them at the specified price. A solution to this problem is available, however. It is that the agency would maintain a stock of marketable securities—e.g., Treasury bills—and stand ready to deliver enough bills to be worth in dollars the current value of the bundles demanded.³ This solution was proposed by Leland Yeager and Robert Greenfield, who also developed the basic idea—albeit with a more *laissez-faire* thrust than here—as long ago as 1983.⁴

In sum, it is possible to do a much better job of stabilizing the price level—the inverse of the purchasing power of money—than would be provided by reliance on a gold standard. This could be accomplished by governmental specification of a comprehensive price index, rather than the price of gold, that the monetary authority would be directed to keep at a virtually constant level over time, which could be accomplished by standing ready to buy or sell (via a redemption medium such as Treasury bills) bundles of goods and services specified by this comprehensive index. For the U.S., for example, Congress could designate a widely-defined price index (such as the CPI) and assign the Federal

² Here I am assuming that a gold standard would be one of the type that Friedman (1961) terms a “pseudo gold standard,” in contrast with one in which the circulating medium of exchange is gold coins and bullion. I believe that even the most fervent proponents of the gold standard today do not recommend adoption of what Friedman terms a “real gold standard.” In this regard see, for example, Grant (2009).

³ The current value could be provided almost minute by minute by internet facilities.

⁴ See, for example, Greenfield and Yeager (1983) and Yeager (1992).

Reserve the technical task of keeping the associated inflation rate equal to (or at least close to) zero.⁵

Alternatively, if focusing entirely on price-level behavior is judged too stringent—that is, too unconcerned with real output and employment—it would be possible for the assigned task to be to keep some measure of aggregate nominal spending (such as nominal GDP or final demand) growing steadily at rate designed to yield an average inflation rate of zero (or some specified small number).⁶ A setup of this type would, like the basic price-level target proposal, provide the United States with a clear *monetary standard*, which we do not have at present, and would designate the Fed’s duties in such a way that the Fed would have operational independence, which could then be used in meeting the standard specified, *in accordance with the Constitution*, by the Congress.

⁵ Here I am not taking a position as to whether the system should permit base drift. In choosing the index and perhaps in setting the target inflation rate, the Congress should of course take advantage of professional expertise in such matters, which would (I believe) correctly involve considerable discussion with officials and economists of the Federal Reserve System, as well as other monetary scholars.

⁶ For additional discussion of nominal GDP growth rules, see McCallum (1988, 1990, 1995).

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