Economic Insights

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Rediscovering the Value of Honest Money

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We have stopped thinking of sound money as honest money. When our government issues money, we have a right to expect that money to be worth tomorrow what it is today. If you think about it, government-issued money is a contract with the people. Inflation is taxation without representation.

It seems you can hardly pick up a paper or turn on the news these days without seeing something about all the efforts on Capitol Hill to redefine the way Congress and the president carry out their fiscal responsibilities. The balanced budget amendment. A line-item veto. Legislation to limit unfunded federal mandates. When you stop and think about it, you have to wonder how things got so bad in the first place.

Traditionally, Americans have expected prudence in government spending. The government and public took it for granted that budgets should be balanced, except, perhaps, in major emergencies or extraordinary circumstances, such as war or depression. But once Keynes convinced us that the budget was a legitimate policy tool to be manipulated to fine-tune the economy, the moral commitment to a balanced budget withered away. I would argue that much the same thing has happened to our resolve against inflation.

The advantages of price stability, or a stable value of the dollar, are many and varied. Price stability is a worthy goal in itself, and it also offers the best financial environment for achieving other important national goals, such as maximum output and employment growth. Since many of the advantages of price stability are self-evident, I am somewhat perplexed as to why the constituency for it seems so weak among the business community and the public. One gets the impression that most people are content with 3-percent inflation, even though the rule of 72 says that prices will double every 24 years with 3-percent inflation.

It is true that 3-percent inflation is good by the standards of the 1970s, and even the 1980s, but it's not so good by earlier standards. Recall that President Nixon declared a national emergency and imposed price and wage controls in 1971 when inflation had climbed to the dangerous level of 4 percent.

For much of our history, sound money was imposed externally by our commitment to gold convertibility, directly or indirectly. Going off the gold standard in the early 1970s may have been the smart thing to do under the circumstances; it may even have been the only alternative at the time. I must admit, however, that our experience with price stability since then has not been as good as it was before.

One problem with our national commitment to sound money probably is the progress we have made on inflation since the 1970s. With that experience fresh in our minds, we willingly underwent wrenching adjustments in the early 1980s to break the back of inflation. As progress was made and our memories faded, our determination has waned. We have stopped thinking of sound money as honest money.

When our government issues money, we have a right to expect that money to be worth tomorrow what it is today. If that is too high a standard, shouldn't we at least try? We have a right to expect that what we save for our children's education or for their inheritance will hold its value. If you think about it, government-issued money is a contract with the people. Inflation is taxation without representation.

People wiser and more articulate than I have given eloquent voice to my thoughts about money. One was the Rev. Robert Sirico, president of the Acton Institute for the Study of Religion and Liberty, who addressed a group of business leaders during a luncheon at the Dallas Fed. He spoke of the concept of honest money as it is founded in the Bible.

The other person who stated the case for honest money so eloquently was the late Henry Wallich, former college professor, columnist and member of the Federal Reserve Board of Governors. He did so in a commencement address 17 years ago. I find it somewhat comforting that his remarks still ring true today.

In this first issue of *Economic Insights,* I am sharing the honest money messages of Father Sirico and Henry Wallich. I'd enjoy hearing what you think. Please write me at the address on the back, or fax me your thoughts at (214) 922-5268. ■

Honest Money

The following is an edited excerpt from Henry C. Wallich's commencement address delivered to the Fordham Graduate School of Business on June 28, 1978.

Inflation introduces an element of deceit into most of our economic dealings. Everybody makes contracts knowing perfectly well that they will not be kept in terms of constant values. This condition is hard to reconcile with simple honesty.

At this time, you are presumably looking at your future role in the world in the broadest possible sense, including a moral sense. Today, I would like to talk to you about one aspect of your future that has a moral dimension, although it is technically an economic problem. I mean the breakdown in our standards of measuring economic values, as a consequence of inflation.

Inflation introduces an element of deceit into most of our economic dealings. Everybody makes contracts knowing perfectly well that they will not be kept in terms of constant values. Everybody expects the value of the dollar to change over the period of a contract. But any specific allowance made for inflation in such a contract is bound to be a speculation. The most valuable part of the contract may turn out to be the paper it is written on. This condition is hard to reconcile with simple honesty.

If our contracts were made in terms of unpredictably shifting measures of weight, time or space, as we buy food, sell our labor or acquire real estate, we would probably regard that as cheating and as intolerable. Yet the case is much the same when we are dealing with monetary values.

The moral issues posed by inflation go beyond what I consider deceit. Inflation is a means by which the strong can more effectively exploit the weak. The strategically positioned and well-organized can gain at the expense of the unorganized and the aged.

In the eyes of economists and of government, inflation becomes a means of exploiting labor's *money illusion*, its supposed failure to anticipate inflation correctly. The device through which this mechanism operates is the well-known *Phillips curve*, the alleged trade-off between unemployment and inflation. It is believed that labor will respond to a seemingly large wage offer that subsequently is eroded by inflation. If labor fails to notice the trick, it will keep working for less than it really had demanded, and employment will be higher. A government pretending to serve a nation's interest by, say, misinforming the people about its military plans would be harshly taken to task. Why should trading on the people's money illusion be regarded any differently?

Meanwhile, planning ahead becomes more difficult for business. Investment lags because long-term commitments involve risks that inflation makes incalculable. The need to guard against these unknowable risks compels each party to any transaction, buyer and seller, employer and employee, lender and borrower, to introduce a risk premium into his pricing. Each must demand a little more or offer a little less than he would under noninflationary conditions. That reduces the range of possible bargains and the level of economic activity. Fewer jobs and less output in the private sector are the results.

Inflation also undermines the honesty of our public policies. It allows the politician to make promises that cannot be met in real terms because, as the government overspends trying to keep those promises, the value of the benefits it delivers shrinks.

Finally, inflation becomes a means of promoting changes in our economic, social and political institutions that circumvents the democratic process. Such changes could be forced upon a reluctant nation because inflation may end up making the existing system inviable. One instance is the diminishing ability of households to provide privately for their future. Personal savings, insurance and pension funds all become inadequate. Money set aside in any of these forms for old age, for sickness, for education could be wiped out by accelerating inflation. One may indeed ask whether it is not an essential attribute of a civilized society to be able to make that kind of provision for the future. But that is not the point I want to stress. Rather, I want to emphasize that the increasing uncertainty in providing privately for the future pushes people who are seeking security toward the government.

By one route or another, inflation creates a vacuum in the private sector into which the government moves. By making the performance of the economy inadequate, inflation is likely to induce expanded government activity. Of the three great dimensions of our society—private rather than public ownership, decision-making by the market rather than by central planning and democracy rather than authoritarianism—private ownership and market decision-making will then be in retreat. No one can say how long, under such conditions, a shift also in the third dimension, away from democracy and toward authoritarianism, can be avoided.

What can be done? Before we look for remedies, we must examine the causes. Inflation is like cancer—many substances are carcinogenic, and many activities generate inflation. The sources of inflation can be diagnosed at several levels. The familiar debate about the sources of violence provides an analogy. Do guns kill people? Do people kill people? Does society kill people? Some assert that money, and nothing but money, causes inflation—the "guns kill people" proposition.

Some assert that the entire gamut of government policies, from deficit spending to protectionism, to minimum wage to farm price supports, to environmental and safety regulations, causes inflation—the "people kill people" proposition. Some argue, finally, that it is social pressures, competition for the national product, a revolution of aspirations, which is at the root—the "society kills people" proposition. The first view holds the central bank primarily responsible for inflation, the second the government in general, the third the people who elect and instruct the government.

In addition, time preference, the social discount rate, enters into the equation. Inflation usually is the final link in a chain of well-meant actions. The benefits of a tax cut, of increased public spending, are felt within a few weeks or quarters. The penalty in terms of inflation may not come until after a couple of years or even later. Inflation is the long-run consequence of short-run expediencies. Life, to be sure, is a succession of short runs, but every moment is also the long run of some short-run expediency of long ago. We are now experiencing the long-run consequences of the short-run policies of the past. These consequences are as unacceptable as rain on weekends and just as easy to change. If we continue to meet current problems with new short-run devices, the bill will keep mounting.

We will not defeat inflation if we always take the short view. We will then always find that the cost of fighting inflation is too high, the short-run loss of output and employment too great. We shall find ourselves ignoring inflation, in the hope that it will somehow not grow worse. That is pure self-deception. Cancer ignored does not become stationary, and neither does inflation. Inflation ignored accelerates.

A long view is needed on inflation. It is a view very different from that of the politician, who is under enormous pressure to do quickly something that looks good. Harold Wilson said that in politics one week was a long time. More charitably, the pressure is until the next election. If the people will not instruct their elected representatives to do the things that are needed to end inflation, if they turn them out of office because the remedies take time and are temporarily painful, we will keep getting a little more employment and output now at the expense of much more unemployment and loss of output later. And we will get more inflation all along the way, down to its ultimate consequences. We need to make the ending of inflation our first priority. That must be our overall policy.

If inflation is a moral problem, we require a moral solution—that is, a recognition that public policies have led to serious inequities affecting people in different and unequal ways and a commitment to new policies that will correct the cumulative distortions and contribute to desired economic progress. Nothing will stop inflation overnight, and in the short run, the gains will always seem dearly won. But without such a long-run approach, the damage will mount and the ultimate costs will escalate. ■

Inflation is a means by which the strong can more effectively exploit the weak. The strategically positioned and well-organized can gain at the expense of the unorganized and the aged.

Henry C. Wallich served as a member of the Federal Reserve Board of Governors from 1974 to 1986. For a copy of the complete text of his commencement address, please write to the Federal Reserve Bank of Dallas, Public Affairs Dept., 2200 N. Pearl St., Dallas, Texas, 75201, or fax your request to the Public Affairs Dept. at (214) 922-5268.

Examining the Moral Dimensions of Monetary Policy

The following excerpts are from the Rev. Robert A. Sirico's luncheon address delivered at the Federal Reserve Bank of Dallas on February 25, 1994.

Certainly, if it is wrong for individuals to deceitfully change the weights and measures in their transactions, it is also morally incumbent upon other institutions, especially government, to keep honest weights and measures.

Before the turn of this century, an entire generation of preachers and ministers concluded that a moral monetary policy was an easy-money policy. "Give the people more money and credit," was the cry of the populist ministers. "Down with gold, up with silver." They mistakenly believed that the Treasury's printing press was the key to earthly salvation.

Even as late as the 1940s, this ideology is evident in film. As much as I love the Christmas classic, "It's a Wonderful Life," a careful viewer can detect its social credit homiletics.

Even today, no matter which party holds the White House, the Federal Reserve consistently faces pressure to keep interest rates artificially low, buy more government debt and trade quick economic fixes for long-term capital accumulation.

Yet, it seems to me, honesty and morality weigh in on the side of the grand tradition of sound and stable money. Holy Scripture speaks of money in terms of weight, just as it was spoken of throughout history. In the list of commandments, tampering with those weights ranked among the behaviors condemned from Above. Certainly, if it is wrong for individuals to deceitfully change the weights and measures in their transactions, it is also morally incumbent upon other institutions, especially government, to keep honest weights and measures.

Allow me to provide a few examples. God told the Israelites that economic transactions should take place with honest weights. Leviticus 19:35–37, instructs, "You shall do no wrong in judgment, in measure of weight, or capacity. You shall have just balances and just weights."

This was long before the followers of Keynes revealed to us the dangerous "liquidity trap" that might result from such "outdated" morals.

Again, Proverbs 11:1 announces that, "A deceitful balance is an abomination before the Lord: but a just weight is His will." But, of course, this was before we discovered the mysterious "magic" of debt monetization.

Proverbs 20:10 says, "Diverse weights and diverse measures, both are abominable before God." Would that Solomon had known about the trade-off between inflation and employment, as revealed by the *Phillips curve*, now back in vogue.

It is true that Isaiah (1:22) warned that "faithless princes" can turn silver "into dross." But that was before we knew how much debtors can gain from paying back dollars that are cheaper than those they borrowed.

I'll grant that the prophets Amos (8:5) and Micah (6:10) condemned deceitful balances when selling wares. But neither knew much of the balance of trade with Japan.

Actually, all these scriptural references make an important moral and economic point. The long history of inflation reveals the tragic consequences of excessive money creation. It can, literally, turn a society upside down. It did in Germany, in the famous hyperinflationary period of 1921–23. It did in this country in the late 1970s. It has in innumerable developing countries. Control of the printing presses is probably a first order condition to a solid economy and stable social order. So much for the magic of credit expansion. ■

The Rev. Robert A. Sirico is founder and president of the Acton Institute for the Study of Religion and Liberty, based in Grand Rapids, Michigan.

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