Eichengreen Fallacy Misleads Some 'Market Monetarists,' Part One

By Ralph Benko
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AEI's James Pethokoukis and *National Review's* Ramesh Ponnuru — among many others — appear to have fallen victim to what I have called "the Eichengreen Fallacy," the demonstrably incorrect proposition that the gold standard caused the Great Depression. This fallacy is at the root of much confusion in the discourse.

Both these conservatives find themselves, most incongruously, in the company of Professors Paul Krugman, Brad Delong, and Charles Postel; Nouriel Roubini; Thomas Frank; Think Progress's Marie Diamond; the Roosevelt Institute's Mike Konczal and other leading thinkers of the left pouring ridicule on the gold standard. Most recently, Matt O'Brien, of the *Washington Post*, hyperbolically described the gold standard as "the worst possible case for the worst possible idea," echoing a previous headline of a blog by Pethokoukis "The case for the gold standard is really pretty awful."

Mssrs. Pethokoukis and Ponnuru appear to have been misled by an ambient fallacy (reprised recently by *Bloomberg View*'s Barry Ritholtz) that there is an inherent deflationary/recessionary propensity of the gold standard. Thus they are being lured into opposition to such respected center-right thought leaders as Lewis E. Lehrman (whose Institute's monetary policy website I professionally edit); Steve Forbes, Chairman of Forbes Media; Sean Fieler, chairman of American Principles in Action (for which I serve as senior advisor, economics) and the Honorable Steve Lonegan, APIA's monetary policy director.

They also put themselves sideways with Cato Institute president John Allison; Professors Richard Timberlake, Lawrence White, George Selgin and Brian Domitrovic; Atlas Economic Research Foundation's Dr. Judy Shelton; Ethics and Public Policy Center's John Mueller; public figures such as Dr. Ben Carson and, perhaps, Peter Thiel; journalists such as George Melloan and James Grant; and *Forbes.com* commentators John Tamny, Nathan Lewis, Peter Ferrara, and Jerry Bowyer, among others.

At odds, too, with such esteemed international figures as former Indian RBI deputy governor S.S. Tarapore; former El Salvadoran finance minister Manuel Hinds; and Mexican business titan Hugo Salinas Price. And, at least by way of open-mindedness and perhaps even outright sympathy, *The Weekly Standard* editor-in-chief William Kristol; Cato's Dr. James Dorn;

Heritage Foundation's Dr. Norbert Michel; the UK's Honorable Kwasi Kwarteng and Steve Baker … among many other respected contemporary figures. Not to mention libertarian lions such as the Honorable Ron Paul.

Gold advocates and sympathizers from the deep past include Copernicus and Newton, George Washington, Alexander Hamilton, Thomas Jefferson, John Witherspoon, John Marshall and Tom Paine, among many other American founders; and, from the less distant past, such important thinkers as Carl Menger, Ludwig von Mises and Jacques Rueff, as well as revered political leaders such as Ronald Reagan and Jack Kemp.

Alan Greenspan recently, in *Foreign Affairs*, while not discerning gold on the horizon, recently celebrated the "universal acceptability of gold" while raising a quizzical avuncular eyebrow, or two, at what he describes as "fiat" currency. He repeated his assessment before the Council of Foreign Relations.

Let not pass unnoticed the recent statement by Herr Jens Wiedmann, president of the Bundesbank,

Concrete objects have served as money for most of human history; we may therefore speak of commodity money. A great deal of trust was placed in particular in precious and rare metals – gold first and foremost – due to their assumed intrinsic value. In its function as a medium of exchange, medium of payment and store of value, gold is thus, in a sense, a timeless classic.

Nor let pass unnoticed the Bank of England's 2011 *Financial Stability Paper No. 13* assessing the long term performance of the Federal Reserve Note standard and assessing its real outcomes — in every category reviewed, including job creation, economic growth, and inflation — to have proven itself, over 40 years, as deeply inferior in practice to the gold and even gold-exchange standards.

Seems a puzzling *mésalliance* on the part of Mssrs. Pethokoukis and Ponnuru.The Eichengreen Fallacy — that the gold standard caused and protracted the Great Depression — has led the discourse severely astray. It is imperative to set matters straight. As I previously have written:

Prof. Eichengreen, author of *Golden Fetters*, was and remains non-cognizant of a subtle but crucial aspect of world monetary history — and, apparently, of the works of Profs. Jacques Rueff and Robert Triffin elucidating the implications. Eichengreen blundered by attributing the Great Depression to the gold standard. This, demonstrably, is untrue.

As Lehrman puts it, the true gold standard repeatedly has proven, in practice, the least imperfect of monetary regimes tried. Robust data actually recommend the gold standard as a powerful force for equitable prosperity.

Just perhaps it can be bettered. So let the games begin. That said, proposing alternatives to the gold standard is very different from denigrating it.

Pethokoukis (whose writings I regularly follow with appreciation) recently presented, at AEIdeas, *The gold standard is fool's gold for Republicans.* This was a riposte to my here calling him to task for insinuating a connection between the gold standard and the rise of the Nazis and Hitler. And to task for making statements in another of his *AEIdea* blogs taking Professors Beckworth and Tyler Cowen out of context. He also therein conflated the "weight of the evidence" with "weight of opinion." It appears that he has fallen prey to the Eichengreen Fallacy.

In self-defense Pethokoukis cites scholarly materials which tend to prove the innocence of the gold standard rather than his insinuation. For example: he cites Prof. Beckworth's statement that "the flawed interwar gold standard … probably … led to the Great Depression which, in turn, guaranteed the rise of the Nazis…."

Prof. Beckworth's characterization "flawed" is entirely consistent with the characterization by the great French monetary official and savant Jacques Rueff, whose work informs my own, of the gold-exchange standard as "a grotesque caricature" of the gold standard.

Similarly, his reference to Prof. Sumner overlooks the obvious fact that Prof. Sumner would appear fully to grasp the key distinction. Sumner, as quoted by Pethokoukis:

The gold standard got a bad reputation after the Great Depression, when it was seen as contributing to worldwide deflation. Kurt Schuler points out that the interwar gold standard didn't follow the rules of the game, which is true.

Pethokoukis speculates,

Perhaps advocates are so sensitive to charges that the gold standard played a key role in the Great Depression, that nuance gets lost in their knee-jerk counterattacks. After all, many gold bugs think their moment is approaching once again. As Ron Paul wrote in his 2009 book "End the Fed": " … we should be prepared for hyperinflation and a great deal of poverty with a depression and possibly street violence as well." And when the stuff hits the fan, nations will again return to the gold standard for stability. Or so goes the theory over at Forbes.

Notwithstanding my high regard for Dr. Ron Paul I have not shared in prognostications of hyperinflation, poverty, and possible street violence. If such sentiments have occurred at *Forbes.com*, whose columnists trend to the classical liberal rather than Austrian model preferred by Dr. Paul, they are vanishingly rare. To indict *Forbes.com* by imputing Dr. Paul's views here suggests a lack of familiarity with these publications. There are some crucial distinctions to which his attention hereby is invited.

There are some civil disputes amongst various camps of gold standard proponents. They are far less material than the demonstrably incorrect fallacy that the authentic gold standard has deflationary tendencies which precipitated the Great Depression. Once this fallacy is dispelled, James Pethokoukis and Ramesh Ponnuru may find it congenial to adopt a different posture in the — steadily rising — debate over the gold standard. They, as do Profs. Beckworth and Sumner, might find themselves arguing for their version of a better policy rather than denigrating the case for gold standard as, in Pethokoukis's words, "pretty awful."

To be continued.