
Monday, February 18, 2008

ECONOMIC BEAT

Greenspan Was Right: The Case for Gold, Part I

By GENE EPSTEIN

"**UNDER THE GOLD STANDARD**," observed Alan Greenspan in a 1966 essay, "a free banking system stands as the protector of an economy's stability and balanced growth."

As you probably heard, a serious bout of instability caused by major imbalances currently plagues the U.S. economy. So a free banking system under the gold standard must be just what the economy needs, if Greenspan had it right.

In that same essay, the future Fed chairman saw another key advantage to a gold standard. While taxing and borrowing against future taxes were the conventional ways government raised revenue, the abandonment of gold permitted a third way: "chronic deficit spending" effectively financed by the "unlimited expansion of credit." A gold standard would end that abuse.

But adoption of gold is not exactly high on the world's agenda. Accordingly, this first installment in my two-part case for gold began with Alan Greenspan's oft-cited essay (called "Gold and Economic Freedom") for a strategic reason. Atlantic.com blogger Megan McCardle was wrong to call the gold standard a "terrible idea." But she was obviously right to point out that "so few economists [are] willing to raise their voices in support of" any version of a gold standard.

It might therefore help to remind readers that the most respected Federal Reserve chairman ever raised his voice in just this way as a seasoned economist of 40, in an essay that was brief but mainly focused on the right arguments. Also, Alan Greenspan's 2007 memoir, *The Age of Turbulence*, adds to the case for gold, while incidentally helping to suggest why "so few economists" are gold advocates.

DOW JONES REPRINTS



This copy is for your personal, non-commercial use only. To order presentation-ready copies for distribution to your colleagues, clients or customers, use the Order Reprints tool at the bottom of any article or visit: www.djreprints.com. • [See a sample reprint in PDF format](#) • [Order a reprint of this article now](#).

The long-standing alternative to gold is, after all, the central banking system, in whose service more than a few economists have found tangible career benefits. That may help explain why *The Age of Turbulence* never mentions the main point that Greenspan himself made in "Gold and Economic Freedom": that gold would protect the economy from the instability of business cycles. In fact, nowhere does he mention the essay itself. We can only conjecture about the omission in a book that is supposed to chronicle his intellectual development, and which otherwise mentions gold.

I conjecture that he found the argument an affront to his career as a central banker. Indeed, the same

essay he buries down the memory hole aggressively indicts the Federal Reserve for playing a destabilizing role. We can regard the 1966 essay as representing his most recent thought to date on this point, since nothing else is available.

The Age of Turbulence does make an additional point in favor of gold not mentioned in that original essay: that a gold standard would prevent price inflation. In the most disturbing, and valuable, section of this book, Greenspan sees an end to the era of tame price increases, beginning around 2030. He points out, first, that the benign "disinflationary pressures" from economies like that of China will have played out by then. And at the same time, inflationary pressures could be intensified by the fiscal "tsunami" brought on by retiring baby boomers.

He affirms that gold would check price inflation, referring to the "gold standard's inherent price stability." So why not support gold for this important reason? It turns out that, while the Greenspan of 1966 objected to chronic deficits financed by "an unlimited expansion of credit," the Greenspan of 2007 now accepts that very thing. "I have long since acquiesced in the fact that the gold standard does not readily accommodate the widely accepted ...view of the appropriate functions of government," he candidly admits -- namely, the "propensity of Congress to create benefits for constituents without specifying the means by which they are to be funded."

But to accept the government's power "to create benefits...without specifying the means by which they are to be funded" is effectively to endorse the government's right to finance its operations, not just through taxing and borrowing, but through the unilateral creation of money and credit. On this point, gold advocate George Reisman observes: "When the government need not obtain its funds from the people, but instead can supply the people with funds, it can no longer easily be viewed as deriving its powers and rights from the people."

So let us repeat Alan Greenspan's three main arguments for gold. A gold standard will protect the economy from 1) the business cycles that have long burdened it and 2) the rapid price inflation that Greenspan sees as a future plague. It also will 3) prevent the government from raising funds through the unilateral expansion of money and credit that Greenspan used to regard as a plague on our freedom.

What more overwhelming case can possibly be imagined? For part 2 on this subject, read next week's column.

E-mail comments to mail@barrons.com¹

URL for this article:

<http://online.barrons.com/article/SB120312013624372883.html>

Hyperlinks in this Article:

(1) <mailto:mail@barrons.com>

Copyright 2008 Dow Jones & Company, Inc. All Rights Reserved

This copy is for your personal, non-commercial use only. Distribution and use of this material are governed by our [Subscriber Agreement](#) and by copyright law. For non-personal use or to order multiple copies, please contact Dow Jones Reprints at 1-800-843-0008 or visit www.djreprints.com.