Hayek on Money: “Let the people choose”

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“With the exception only of the 200-year period of the gold standard (1714 to 1914 in Britain), practically all governments of history have used their exclusive power to issue money in order to defraud and plunder the people.”

In 1976, Nobel laureate economist Friedrich Hayek wrote these bold words in a published address called *Choice in Currency: A Way to Stop Inflation* (download below). In it, Hayek makes the direct and commonsensical argument that the only true way to fight inflation was to keep government honest, and the only way to keep government honest was to take away government’s legal privilege to issue money exclusively. Hayek’s proposal was simple: repeal “legal tender” laws and let the people use whatever sort of money they want.

According to Hayek’s research, history proved two things: 1) that all representative governments eventually abuse their money-issuing privileges, which results in inflation; and 2) that people with access to various types of money always look for the most stable kind – usually gold or silver.

Therefore, Hayek proposed that the European Economic Community – the institutional precursor to the European Union – should not push for a single, uniform European currency but simply enact laws which would permit the free flow and use of all currencies throughout Europe. For instance, Germans could use francs in Germany; the British could use Deutsch marks in Britain; or the French could use pounds in France.

The result would be that the best money would be used, while the bad money – that is, the money which was being over-issued and, thus, inflated – would be readily discarded.
But is this not the opposite of Gresham’s Law – that economic “law” that states that good money will fall out of circulation in such an environment? Not exactly. Hayek explains:

“But the truth which apparently even today is not generally understood is that Gresham's Law operates only if the two kinds of money have to be accepted at a prescribed rate of exchange. Exactly the opposite will happen when people are free to exchange the different kinds of money at whatever rate they can agree upon. This was observed many times during the great inflations when even the most severe penalties threatened by governments could not prevent people from using other kinds of money---even commodities like cigarettes and bottles of brandy rather than the government money---which clearly meant that the good money was driving out the bad.” (pgs. 18-19)

And what is good money, you ask? Hayek said it plainly: gold. It is “the universal prize in all countries, in all cultures, in all ages.”

Today, gold is still that prize. In fact, according to World Gold Council statistics, the global (investment) demand for gold continues to grow on a year-by-year basis at an incredible 33%. (Make that 135% in Europe.) And it is predicted that demand will increase again over the course of 2012.

This is all evidence that supports Hayek’s proposition that gold remains the kind of “universal prize” of which he spoke.