The Constitutionalization of Money

James M. Buchanan

The market will not work effectively with monetary anarchy. Politicization is not an effective alternative. We must commence meaningful dialogue with acceptance of these elementary verities. Far too much has been said and written in elaboration of the first statement, which too often is taken to be equivalent to the assertion that "capitalism" or "the market" has failed. Admittedly claims for market efficacy without qualifiers can be found. But economists should know that anarchy can only generate disorder rather than its opposite.

Within a regime of stability in property rights, contracts, and money, persons will interact, one with another, to generate an order that will produce and distribute value, as determined by their own choices, which they remain at liberty to make. This claim was made by Adam Smith in 1776, but his emphasis on the necessary "laws and institutions" is too often overlooked. Importantly, this precept also informed the thinking of the American Founders, who explicitly included money in their constitutional assignment of authority.

Acceptance of the two precepts noted, however, prompts the query: If anarchy in money fails along with politicization, how can the market economy ever be expected to function effectively? The Scylla and Charybdis metaphor seems all too appropriate, until we recognize that the limits here are behavioral rather than natural. Anarchy

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and politics both fail because persons do not act within constraints that are not beyond the physically possible.

The Hobbesian Covenant

How can we escape? Here I suggest that we look for initial inspiration from Thomas Hobbes, who placed *security* as the first desideratum to be sought in any anarchistic setting. We need to amend Hobbes by extending the umbrella to include money and to do so with the understanding that security is reckoned in the stability and/or predictability in value. But the first Hobbesian step, the very assignment of money to the sovereign's control, seems to politicize the structure, almost by definition, so that the second initial statement above applies.

Herein lies the location of intellectual-scientific failure on the part of political economists, political philosophers, political leaders, and members of the public. There has been near-universal breakdown in elementary understanding that the political-economic-legal order observed in Western democracies involves the exercise of sovereignty in two stages or levels—that which defines and enforces the constraints of a constitution and that which operates within the limits so defined. To Hayek, this created the distinction between "law" and "legislation," between the "higher law" and the legislation that emerges from ordinary collective action. My own usage of terms here has been to distinguish between constitutional constraints and post-constitutional or within-constitutional action.

The leap from Hobbesian anarchy is accomplished when participants select the set of constraints that identify their separated rights and duties along with the enforcing institutions. Within any set of constraints, so established, the possible range and scope for collective action remains open within broad limits. Almost all analysis and discussion involves movements along this within-constitutional setting, with relatively little attention at all to the framework rules.

The anarchistic setting introduced here may suggest that my whole argument is open to the criticism that has been directed toward Hobbes over the three and one-half centuries since he wrote. The conceptualized contractual agreement between the people and the sovereign has been challenged as being ahistorical and adescriptive, as well as being justificatory for tyranny. Positivist critics point to the evolutionary origins of the institutions in being along with the coercive seizures of authority, none of which even remotely parallels the Hobbesian conjectural rendering.

A more judicious reading may suggest that Hobbes's purpose was not historical, descriptive, or justificatory. Instead Hobbes sought to offer a rationality-based logic for the surrender of authority to the sovereign, along with adherence to its dictates, and, on the part of the sovereign, the enforcement of security as promised, while remaining within the boundaries of the covenant.

My central proposition is that security in money's value is almost totally absent from this conjectural scenario, but that it could be readily appended. Admittedly, the whole approach taken may seem to be provincially American.

Note that in the Hobbesian construction, as interpreted and amended here, the security, or order, provided by the sovereign is, in itself, a Samuelsonian public good, in the terminology of welfare economics. All participants in the political economy secure benefits; there are no well-defined winners and losers; distributional impacts remain muted; generality rather than particularity characterizes the whole process.

As noted, security in the value of money has been almost wholly absent from discussions about the familiar Hobbesian construction, widely used positively as a justification for the rule of law. At the same time, I submit that the current monetary setting carries an eerie similarity to that in the 17th-century imagination of Thomas Hobbes concerning nonmonetary rights and claims.

Why the Neglect of Money?

In the Hobbesian discussion of sovereignty and security, emphasis has almost exclusively been centered on persons and real property, defined in physical rather than value dimensions. It becomes rather easy to explain Hobbes's own neglect. In the middle of the 17th century, market exchanges were not well developed, and values were not readily measured. Only in the ensuing decades and centuries did monetary values come to be important, but these were never included in the Hobbesian security umbrella, in part because of the near-universal acceptance of gold as the commodity base for money. And, of course, gold itself qualified for inclusion as real property.

Although the analytical conceptualization of the abstract role of money in an exchange economy became familiar to economists, and especially from David Hume on, the relevant measure became the value of the base commodity, gold, rather than money, as such. In this respect, at least, the dominance historically of the international gold standard bears major responsibility for spreading confusion rather than enlightenment. Although the idealization of the neutrality of money did enter specialized discourse among economists, the possible implications for implementing structural adjustments were, to my knowledge, rarely examined. And, as the limited and ultimately ineffectual constraints exercised by the gold standard, as it operated in reality, were allowed to disappear, the ravages of monetary anarchy became visible for all to see.

It becomes relatively easy, therefore, to explain why the value of money was not, even in advanced analyses, deemed appropriate for inclusion in the conjectural Hobbesian contract, as updated for modernity. Further, the discussion was marred by the continuing confusion among classical liberal economists themselves, some of whom argue that anarchy in money is, indeed, the preferred institutional regime.

Money Is Different

Money is not a good in the ordinary sense, as Adam Smith tried to convince his readers a long time ago. Money is different in that, as money, there is no real value. Money offers no survival-enhancing capacity, and itself directly satisfies no sensory or aesthetic desires. In its most abstracted functional embodiment, money has value only because of its potential power to secure real value from others who will voluntarily take money in exchanges. Regardless of its origins, whether as a convention emergent from some evolutionary process or deliberately created by some explicit collective action, because of its lack of real value, the aggregate amount of money, as such, is irrelevant for the basic operation of the production-exchange-distribution nexus that we call "the economy." In its idealized abstract variant, the notion of money as a veil has been a part of economists' everyday understanding, as least since David Hume.

Unpredicted changes in the aggregate amount of money can, however, exert negative effects on the real values generated in the nexus. And these effects may be multiplied if differing instruments are valued as money in separate accounts and if owners-users of such accounts switch as among the entries. These characteristics offer the explanatory basis for monetary crises, including that of 2008–9 as well as the Great Depression in the 20th century. The ultimate villain is the leveraging of monetary accounts, which allows for the transmission of initial shocks over many sectors of the inclusive economy.

As we know, at least since 1971, there has been no commodity basis for money. Instead, the commercial world has been described as embodying a pure paper or fiat unit of exchange and account, which has essentially become the United States dollar. And this unit retains value only to the extent that the effective aggregate supply is kept within limits by the issuing authority, in this case by the Federal Reserve Board. Because money, as such, has no intrinsic value and because it is nearly costless to produce (printing paper), there is no economic reason for economizing on usage, as would be the case if money were defined in terms of a designated commodity, which has nonmoney use value and which requires resources to produce.

Recognition of this elementary but crucial difference between commodity-based and fiat (paper) money has profound implications for institutional-constitutional design and operation. Since, under a fiat system, there is no efficiency logic for economizing on money, as such, there is no justification for traditional banking that allows for the generation of multiple account values from fractional reserve bases. The central logic of leverage banking, of any sort, is absent under the operation of a pure fiat money system.

It follows that there is no economic reason why any money system, in an idealized setting, would allow for leverage at any level. No holder of a unit of money, as an entry in a balance sheet, should be authorized to lend more than the face value of this unit, quite independent of probabilistically determined expectations concerning potential redemptions.

Why not? Because to allow separate banks to create short-term liabilities to a multiple of the base money on the asset side of the account removes from the issuing authority some of the control of the aggregate amount of that value treated as money in the economy without offsetting benefits, thereby making the financial structure vulnerable to unpredictable shifts among instruments, which, in turn, generate changes in real values.

The modern dilemma is that we are left with a massive resource-using, financial-banking structure that has a functional purpose quite different from that which is widely accepted. The system in existence emerged from a historical process, the characteristics of which were partially appropriate for a monetary standard defined in terms of some commodity base, but which, ultimately, make no sense under a fiat system.

Constitutionalization as the Necessary Reform

In this article, I shall not try to outline step-by-step measures that might be suggested to move the complex financial structure in existence toward efficient and effective constitutionality. If the first statements of this article are acknowledged, that is, that neither monetary anarchy nor politicization can work, constitutionalization becomes the only viable option. But it is necessary to clarify what constitutionalization means in this context.

In application to money, the requirement is that the value of the monetary unit be made one of the rules of the game, within which economic interaction takes place, rather than being used as a counter in the strategy of play within the rules. In Hayekian parlance, the value of money must be part of the "higher law," as opposed to ordinary legislation that takes place within such law.

This basic understanding did indeed inform the thinking of the American Founding Fathers, who explicitly assigned monetary authority to the Congress empowering this body "to coin money, and to regulate the value thereof." And, interestingly, this grant of authority is included in the same sentence (Article I, Section 8) as that which assigns the fixing of weights and measures. It is as if the value of money is to be removed from within-rule political manipulation, hence remaining unchallenged as akin to other standards.

If the value of money cannot be left totally alone, in part, in anarchy or left to the machinations of political coalitions, how is the amount, or quantity, which alone gives money value, to be set under a fiat system? Clearly some defined process and institutional structure must be established, with genuine constitutional authority, over and beyond that of democratic majoritarian politics. Something analogous to the independent judiciary, under the Supreme Court, seems required—a monetary authority that is independent of politics, but which remains itself bound by the parameters set out in the constitution itself.

Clearly, the discussion here is related to the modern arguments concerning the independence of central banks, with mounting empirical evidence that the degree of independence is positively correlated with stability in value. Although normally treated in differing terminology, a central bank that remains genuinely independent of political authority has been, in part, constitutionalized. The implications of my arguments here involve more explicit recognition and acknowledgment of the constitutional standing of the monetary authority, along with the accompanying defined, and limited, objectives, without which criteria for success or failure in meeting the security goal cannot be established.

Explicit constitutionalism would also embody the requirement that the monetary authority itself be bound by the rules of the basic contract. Beyond narrow limits, discretion on the part of the authority goes outside the dictates of constitutional criteria.

In the United States setting, monetary authority must be formally constitutionalized by amending the Constitution, a process that, in itself, would modify public attitudes. I shall not make an effort to outline the content of a constitutional amendment. What is important is that the authority that is established be constitutional and that its powers be strong, but limited in scope. Maintenance in the value of the monetary unit must remain the central, if not the only, objective of the authority.

Money as a Symbol of Order

The most important, and surely the most difficult, step in any meaningful constitutionalization of money is the achievement of general public recognition that the value of the monetary unit is, and is expected to be, stable and, hence. predictable as a parameter for economic transactions. This value must be understood to be outside of and beyond the choice set of any participant in the economy, including members of the political coalitions who make budgetary decisions. The value of money must be categorically separated from the values of goods and services emergent in the marketplace, whether or not these values are politicized.

The achievement of the required threshold of acceptance of money in its symbolic significance requires more than some straightforward modification of the formal constitutional status. At the same time, members of the public, all of whom are transactors in money values, must come to trust the value of money as iconically sacrosanct. The whole psychology of money in modern times must become different.

As noted, the necessary discussion-debate over any constitutional establishment of a monetary authority will do much toward setting money apart from historical experience. Attention in itself can become the avenue for education and understanding of the elementary role that money can and must play in any market order and of the net benefits that stability and security in money's value can generate.

We should not expect miracles, but hope is made possible by the recognition that a miracle, in some unnatural sense, is not necessary here. A monetary regime that embodies parametric stability is within the physically possible. The United States came close to the attainment of a new monetary order in the crises of the early 1930s. Perhaps, the crises of 2008–9 can provide space for more successful permanent constitutional change. And if the United States should constitutionalize the dollar, along the lines suggested here, there would be little or no concern about the adherence of other countries to the dollar's continuation as the international unit of account.

Conclusion

I am under no illusion that my suggestion for the constitutionalization of money will do more than enter as but one item in a multifaceted discourse on financial reform over the post-2009 years. My aim is modest. I want to ensure that constitutionalization, as such, is at least recognized in its own right.

In this respect, citizens of the United States commence with an advantage over some others in the international discussions. We share a constitutional heritage, an understanding, a wisdom, that is often absent in political discourse emanating from parliamentary regimes. With us, the Constitution remains the ultimate sovereign authority rather than the government, as such. To look at the Constitution as the vehicle to provide us with the monetary security that must be a part of any complete Hobbesian contract is natural to my countrymen. Let us not waste this set of crises by exclusive recourse to jerry-built efforts to patch up the failed monetary anarchy we have witnessed.