PUBLICATIONS / ARTICLE

FRIEDRICH HAYEK: DECENTRALIZING THE MONETARY SYSTEM

DECENTRALISM FILE

Introduction by John McLaughry

Friedrich A. Hayek

F.A. Hayek (1899-1992) was an Austrian-born economist noted for his criticisms of the Keynesian welfare state and of totalitarian socialism. After military service in WWI and earning doctoral degrees in both law and economics at the University of Vienna, he became associated with the Austrian School of Economics, founded by Ludwig von Mises. From 1932 to 1950 Hayek, who became naturalized British citizen, held a chair at the London School of Economics.

Influenced by Mises' classic work "Socialism"(1923), Hayek became a sharp critic of that school of economic thought, and a champion of classical liberal political philosophy and a market-based economic order. His most influential work among the general public was "The Road to Serfdom" (1944) in which he argued against the accumulation of economic and political power in nation states emerging from WW2.

As summarized in his entry in the Brittanica: "Hayek asserted that in a world of constant change—in which every change of price causes market participants to change their demand and supply, which lead to other adjustments, ad infinitum—no constructed system can match the ability of the market process to adjust continually to the changes. He argued that the market system itself constitutes a "discovery procedure," in that it provides incentives for the discovery of new products and processes while also disseminating information to market participants (e.g., consumers). This occurs because entrepreneurs have incentives to be alert to and to exploit newly discovered or created knowledge. Hayek maintained that a market system aids in the coordination of plans and the correction of errors in a world in which knowledge is dispersed, tacit, and specific to time and place and in which individual beliefs may be wrong. Obversely, price-fixing hinders coordination; attempts to gather knowledge centrally do not permit the best use of localized and tacit knowledge; and no system provides as much feedback and incentives for the correction of errors in perception as does a market system."

"In "The Constitution of Liberty" and elsewhere Hayek identified the social institutions that he felt would most effectively achieve the goal of liberty. He argued that a system of free markets—in a democratic polity, with a private sphere of individual activity that is protected by a strong constitution, with well-defined and enforced property rights, all governed by the rule of law, in which laws are prospective, equally enforced, abstractly stated, and stable—will support the set of institutions that both permits individuals to pursue their own values and allows them to make the best use of their own localized knowledge. In "Law, Legislation and Liberty" he argued that the concept of "social justice" that was often invoked in defending the policies of the modern welfare state was without meaning because it focused on outcomes, rather than actions, and further that special interests are bound to manipulate such moral redistribution schemes to enrich themselves."

In 1974 Hayek shared the Nobel Prize for Economics with socialist Swedish economist Gunnar Myrdal. In its announcement of the award, the Swedish Nobel committee said in part "He presented new ideas with regard to basic difficulties in "socialistic calculating", and investigated the possibilities of achieving effective results by decentralized "market socialism" in various forms. His guiding principle when comparing various systems is to study how efficiently all the knowledge and all the information dispersed among individuals and enterprises is utilized. His conclusion is that only by far-reaching decentralization in a market system with competition and free price-fixing is it possible to make full use of knowledge and information."

Of special interest is Hayek's 1978 argument for a decentralized monetary system, from which an excerpt is included below.

F.A .Hayek, "The Use of Knowledge in Society" 35 American Economic Review 519 (September 1945) (Included as Chapter V in "Individualism and Economic Order" (1948)

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The peculiar character of the problem of a rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we may make use never exists in concentrated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess. The economic problem of society is this not merely a problem, of how to allocate 'given' resources – if 'given' is taken to mean given to a single mind which deliberately solves the problem set by these 'data'.

It is rather a problem of how to secure the best use of resources known to any of the members of society, for ends whose relative importance only these individuals know. Or, to put it briefly, it is a problem of the utilization of knowledge not given to anyone in its totality....

Planning in the specific sense in which the term is used in contemporary controversy necessarily means central planning – direction of the whole economic system according to one unified plan. Competition, on the other hand, means decentralized planning by many separate persons. The half-way house between the two, about which many people talk but which few like when they see it, is the delegation of planning to organized industries, or, in other words, monopoly.

Which of these systems is likely to be more efficient depends mainly on the question under which of them we can expect that fuller use will be made of the existing knowledge. And this, in turn, depends on whether we are more likely to succeed in putting at the disposal of a single central authority all the knowledge which ought to be used but which is initially dispersed among many different individuals, or in conveying to the individuals such additional knowledge as they need in order to enable them to fit their plans in with those of others....

If we can agree that the economic problem of today's society is mainly one of rapid adaptation to changes in the particular circumstances of time and place, it would seem to follow that the ultimate decisions must be left to the people who are familiar with these circumstances, who know directly of the relevant changes and of the resources immediately available to meet them. We cannot expect that this problem will be solved by first communicating all this knowledge to a central board which, after integrating all knowledge, issues its order. We must solve it by some form of decentralization, because only thus can we ensure that the knowledge of the particular circumstances of time and place will be promptly used....

We must look at the price system as such a mechanism for communicating information if we want to understand its real function – a function which, of course, it fulfils less perfectly as prices grow more rigid. (Even when quoted prices have become quite rigid, however, the forces which would operate through changes in price still operate to a considerable through changes in the other terms of the contract.)

The most significant fact about this system is the economy of knowledge with which it operates, or how little the individual participants need to know in order to be able to take the right action."

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Hayek, F. A. "Reason and Tradition," *Ethics*: vol. 58, no. 4, 1958.

"I have elsewhere discussed the various institutions and habits, tools and methods of doing things, which have emerged from this process and constitute our inherited civilization. But we have yet to look more carefully at those rules of conduct which have grown as part of it, which are both a product and a condition of freedom.

Of these conventions and customs of human intercourse, the moral rules are the most important but by no means the only significant, ones. We understand each other and get along with each other, are able to act successfully on our plans because the members of our civilization most of the time conform to unconscious patterns of conduct, show a regularity in their actions which is, not the result of commands or coercion, often not even of any conscious adherence to known rules, but of firmly established habits and traditions.

The general observance of these conventions is a necessary condition of the orderliness of the world in which we live, of our being able to find our way in it,

though we do not know their significance and may not even be consciously aware of their existence. In some instances it would be necessary, for the smooth running of society, to secure a similar uniformity by coercion if such conventions or rules were not observed in most instances. Coercion may thus sometimes be avoidable only because a high degree of voluntary conformity exists which thus may be a condition of freedom. It is indeed a truth, which all the great apostles of freedom outside the rationalistic school have never tired of emphasizing, that freedom has never worked without deeply ingrained moral beliefs, and that coercion can be reduced to a minimum only where the individuals can be expected as a rule to conform voluntarily to certain principles.

A familiar instance of how a firmly established tradition assists frictionless human intercourse is the manner in which in the Anglo-Saxon countries a general familiarity with the rules of parliamentary procedure facilitates all proceedings of groups of men. To one who comes from another milieu it is a source of constant wonder how, as a result of this, a committee of schoolboys in England or the United States is generally more effective than many a group of grave and learned scholars in Germanic or Latin countries. Many similar examples could be given of how the general adherence to rules, which often may be far from rational and whose reasons those who submit to them are far from understanding, assists the effective collaboration of men. The often ridiculed propensity of Englishmen to form a queue at any bus station, which is of course merely the result of the unquestioned acceptance of the rule "first come, first served," is a humbler instance of the same trait. Much of the difference between Anglo-Saxon manners and the more formal, courtly etiquette of the Continent is probably due to the fact that the former have spontaneously developed to smooth intercourse in ordinary life rather than from the organized ceremonial of a hierarchic society.

There is an advantage in obedience to such rules not being enforced by coercion-not only because coercion as such is bad, but because it is in fact often desirable that rules should be observed only in most instances, and that the individual should be able to transgress them when it seems to him worthwhile to incur the odium which this will cause. It is also important that the strength of the social pressure and of the force of habit which insure their observance is variable. It is this flexibility of voluntary rules which makes gradual evolution and spontaneous growth possible, which brings it about that further experience leads to modifications and improvements.

Such an evolution is possible only with rules which are neither coercive nor deliberately imposed-which, though observing them is regarded as merit and though they will be observed by the majority, can be broken by individuals who feel that they have strong enough reasons to brave the censure of their fellows. Unlike any deliberately imposed coercive rules, which can be changed only discontinuously and for all at the same time, growth of this kind makes gradual and experimental change possible. The simultaneous existence of individuals and groups observing partially different rules provides the opportunity for the selection of the more effective ones.

It is this submission to undersigned rules and conventions whose significance and importance we largely do not understand, this reverence for the traditional, that, though it is indispensable for the working of a free society, the rationalistic type of mind finds so uncongenial. It has its foundation in the insight which David Hume stressed and which is of decisive importance for the anti-rationalist, evolutionary tradition that "the rules of morality are not the conclusions of our reason."

Like all other values, our morals are not a product but a presupposition of reason, the ends which the instrument of our intellect has been developed to serve. At any one stage of our evolution, the system of values into which we are born supplies the ends which our reason must serve. This givenness of the value framework implies that, although we must always strive to improve our institutions, we can never aim to remake them as a whole, and that in our efforts to improve them we must take for granted much that we do not understand: We must always work inside a framework of both values and institutions which is not of our own making. It means in particular that we can never synthetically construct a new body of moral rules, or make our obedience of the known rules dependent on our comprehension of what depends on this obedience in the particular instance.

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In Chapter 8 of The Counter Revolution of Science (1952) Hayek explains the intellectual fallacy of assuming that a given state of human affairs resulted from some kind of design or plan purposefully conceived by some supervening entity at some previous time. This concluding paragraph (p. 86) undermines the case for collectivized, centralized control, and defends the case for allowing (decentralized) freedom to generate evolving social relations.

Even more significant of the inherent weakness of the collectivist theories is the extraordinary paradox that from the assertion that society is in some sense “more” than merely the aggregate of all individuals their adherents regularly pass by a sort of intellectual somersault to the thesis that in order that the coherence of this larger entity be safeguarded it must be subjected to conscious control, i.e., to the control of what in the last resort must be an individual mind. It thus comes about that in practice it is regularly the theoretical collectivist who extols individual reason and demands that all forces of society be made subject to the direction of a single mastermind, while it is the individualist who recognizes the limitations of the powers of individual reason and consequently advocates freedom as a means for the fullest development of the powers of the inter-individual process.

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Hayek, F.A. “Denationalisation of Money: The Argument Refined”. The Institute of Economic Affairs, 1978. (3rd edition)

1. THE PRACTICAL PROPOSAL

The concrete proposal for the near future, and the occasion for the examination of a much more far-reaching scheme, is that the countries of the Common Market, preferably with the neutral countries of Europe and possibly later the countries of North America) mutually bind themselves by formal treaty not to place any obstacles in the way of the free dealing throughout their territories in one another’s currencies (including gold coins) or of a similar free exercise of the banking business by any institution legally established in any of their territories. This would mean in the first instance the abolition of any kind of exchange control or regulation of the movement of money between these countries, as well as the full freedom to use any of the currencies for contracts and accounting. Further, it would mean the opportunity for any bank located in these countries to open branches in any other on the same terms as established banks.

Free trade in money

The purpose of this scheme is to impose upon existing monetary and financial agencies a very much needed discipline by making it impossible for any of them, or for any length of time, to issue a kind of money substantially less reliable and useful than the money of any other. As soon as the public became familiar with the new possibilities, any deviations from the straight path of providing an honest money would at once lead to the rapid displacement of the offending currency by others. And the individual countries, being deprived of the various dodges by which they are now able temporarily to conceal the effects of their actions by 'protecting' their currency, would be constrained to keep the value of their currencies tolerably stable.

Proposal more practicable than utopian European currency

This seems to me both preferable and more practicable than the utopian scheme of introducing a new European currency, which would ultimately only have the effect of more deeply entrenching the source and root of all monetary evil, the government monopoly of the issue and control of money. It would also seem that, if the countries were not prepared to adopt the more limited proposal advanced here, they would be even less willing to accept a common European currency. The idea of depriving government altogether of its age-old prerogative of monopolizing money is still too unfamiliar and even alarming to most people to have any chance of being adopted in the near future. But people might learn to see the advantages if, at first at least, the currencies of the governments were allowed to compete for the favour of the public. Though I strongly sympathise with the desire to complete the economic unification of Western Europe by completely freeing the flow of money between them, I have grave doubts about the desirability of doing so by creating a new European currency managed by any sort of supranational authority. Quite apart from the extreme unlikelihood that the member countries would agree on the policy to be pursued in practice by a common monetary authority (and the practical inevitability of some countries getting a worse currency than they have now) it seems highly unlikely, even in the most favourable circumstances, that it would be administered better than the present national currencies. Moreover, in many respects a single international currency is not better but worse than a national currency if it is not better run. It would leave a country with a financially more sophisticated public not even the chance of escaping from the consequences of the crude prejudices governing the decisions of the others. The advantage of an international authority should be mainly to protect a member state from the harmful measures of others, not to force it to join in their follies.

Free trade in banking

The suggested extension of the free trade in money to free trade in banking is an absolutely essential part of the scheme if it is to achieve what is intended. First, bank deposits subject to cheque, and thus a sort of privately issued money, are today of course a part, and in most countries much the largest part, of the aggregate amount of generally accepted media of exchange. Secondly, the expansion and contraction of the separate national superstructures of bank credit are at present the chief excuse for national management of the basic money. On the effects of the adoption of the proposal all I will add at this point is that it is of course intended to prevent national monetary and financial authorities from doing many things politically impossible to avoid so long as they have the power to do them. These are without exception harmful and against the long-run interest of the country doing them but politically inevitable as a temporary escape from acute difficulties. They include measures by which governments can most easily and quickly remove the causes of discontent of particular groups or sections but bound in the long run to disorganize and ultimately to destroy the market order.

Preventing government from concealing depreciation

The main advantage of the proposed scheme, in other words, is that it would prevent governments from 'protecting' the currencies they issue against the harmful consequences of their own pleasures, and therefore prevent them from further employing these harmful tools. They would become unable to conceal the depreciation of the money they issue, to prevent an outflow of money, capital, and other resources as a result of making their home use unfavourable, or to control prices-all measures which would, of course, tend to destroy the Common Market. The scheme would indeed seem to satisfy all the requirements of a common market better than a common currency without the need to establish a new international agency or to confer new powers on a supranational authority. The scheme would, to all intents and purposes, amount to a displacement of the national circulations only if the national monetary authorities misbehaved. Even then they could still ward off a complete displacement of the national currency by rapidly changing their ways. It is possible that in some very small countries with a good deal of international trade and tourism, the currency of one of the bigger countries might come to predominate, but assuming a sensible policy, there is no reason why most of the existing currencies should not continue to be used for a long time. (It would, of course, be important that the parties did not enter into a tacit agreement not to supply so good a money that the citizens of the other nations would prefer it! And the presumption of guilt would of course always have to lie against the government whose money the public did not like! I do not think the scheme would prevent governments from doing anything they ought to do in the interest of a well-functioning economy, or which in the long run would benefit any substantial group. But this raises complex issues better discussed within the framework of the full development of the underlying principle.

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XVIII. MONETARY POLICY NEITHER DESIRABLE

NOR POSSIBLE

"It is true that under the proposed arrangements monetary policy as we now know it could not exist. It is not to be denied that, with the existing sort of division of responsibility between the issues of the basic money and those of a parasitic circulation based on it, central banks must, to prevent matters from getting completely out of hand, try deliberately to forestall developments they can only influence but not directly control. But the central banking system, which only 50 years ago was regarded as the crowning achievement of financial wisdom, has largely discredited itself. This is even more true since, with the abandonment of the gold standard and fixed exchange rates, the central banks have acquired fuller discretionary powers than when they were still trying to act on firm rules. And this is true no less where the aim of policy is still a reasonable degree of stability, as in countries overwhelmed by inflation.

Government the major source of instability

We have it on the testimony of a competent authority who was by no means unsympathetic to those modern aspirations that, during the recent decade 1962 to 1972 when the believers in a 'fine tuning' of monetary policy had an influence which we must hope they will never have again, the larger part of the fluctuations were a consequence of budgetary and monetary policy. And it is certainly impossible to claim that the period since the abandonment of the semi-automatic regulation of the quantity of money has generally been more stable or free from monetary disturbances than the periods of the gold standard or fixed rates of exchange.

We indeed begin to see how completely different an economic landscape the free issue of competitive currencies would produce when we realise that under such a system what is known today as monetary policy would neither be needed nor even possible. The issuing banks, guided solely by their striving for gain, would thereby serve the public interest better than any institution has ever done or could do that supposedly aimed at it. There neither would exist a definable quantity of money of a nation or region, nor would it be desirable that the individual issuers of the several currencies should aim at anything but to make as large as possible the aggregate value of their currency that the public was prepared to hold at the given value of the unit. If we are right that, being able to choose, the public would prefer a currency whose purchasing power it could expect to be stable, this would provide a better currency and secure more stable business conditions than have ever existed before.

The supposed chief weakness of the market order, the recurrence of periods of mass unemployment, is always pointed out by socialists and other critics as an inseparable and unpardonable defect of capitalism. It proves in fact wholly to be the result of government preventing private enterprise from working freely and providing itself with a money that would secure stability. We have seen that there can be no doubt that free enterprise would have been both able to provide a money securing stability and that striving for individual gain would have driven private financial institutions to do so if they had been permitted. I am not sure that private enterprise would adopt the manner of performing the task I have suggested, but I am inclined to think that, by its habitual procedure of selecting the most successful, it would in time throw up better solutions to these problems than anyone can foresee today.

Monetary policy a cause of depressions

What we should have learned is that monetary policy is much more likely to be a cause than a cure of depressions, because it is much easier, by giving in to the clamour for cheap money, to cause those misdirections of production that make a later reaction inevitable, than to assist the economy in extricating itself from the consequences of overdeveloping in particular directions. The past instability of the market economy is the consequence of the exclusion of the most important regulator of the market mechanism, money, from itself being regulated by the market process.

A single monopolistic governmental agency can neither possess the information which should govern the supply of money nor would it, if it knew what it ought to do in the general interest, usually be in a position to act in that manner. Indeed, if, as I am convinced, the main advantage of the market order is that prices will convey to the acting individuals the relevant information, only the constant observation of the course of current prices of particular commodities can provide information on the direction in which more or less money ought to be spent. Money is not a tool of policy that can achieve particular foreseeable results by control of its quantity. But it should be part of the self-steering mechanism by which individuals are constantly induced to adjust their activities to circumstances on which they have information only through the abstract signals of prices. It should be a serviceable link in the process that communicates the effects of events never wholly known to anybody and that is required to maintain an order in which the plans of participating persons match.

Government cannot act in the general interest

Yet even if we assumed that government could know what should be done about the supply of money in the general interest, it is highly unlikely that it would be able to act in that manner. As Professor Eckstein, in the article quoted above, concludes from his experience in advising governments:

'Governments are not able to live by the rules even if they were to adopt the philosophy [of providing a stable framework]'

Once governments are given the power to benefit particular groups or sections of the population, the mechanism of majority government forces them to use it to gain the support of a sufficient number of them to command a majority. The constant temptation to meet local or sectional dissatisfaction by manipulating the quantity of money so that more can be spent on services for those clamouring for assistance will often be irresistible. Such expenditure is not an appropriate remedy but necessarily upsets the proper functioning of the market.

In a true emergency such as war, governments would of course still be able to force upon people bonds or other pieces of paper for unavoidable payments which cannot be made from current revenues. Compulsory loans and the like would probably be more compatible with the required rapid readjustments of industry to radically changed circumstances than an inflation that suspends the effective working of the price mechanism.

No more balance-of-payment problems

With the disappearance of distinct territorial currencies there would of course also disappear the so-called 'balance-of-payment problems' believed to cause intense difficulties to present-day monetary policy. There would, necessarily, be continuous redistributions of the relative and absolute quantities of currency in different regions as some grew relatively richer and others relatively poorer. But this would create no more difficulties than the same process causes today within any large country. People who grew richer would have more money and those who grew poorer would have less. That would be all. The special difficulties caused by the fact that under existing arrangements the reduction of the distinct cash basis of one country requires a contraction of the whole separate superstructure of credit erected on it would no longer exist.

Similarly, the closer connections of the structure of the prices prevailing within any one country as against prices in neighbouring countries, and with it the statistical illusion of the relative movement of distinct national price levels, would largely disappear. Indeed it would be discovered that 'balance-of-payment problems' are a quite unnecessary effect of the existence of distinct national currencies, which is the cause of the wholly undesirable closer coherence of national prices than of international prices. From the angle of a desirable international economic order the 'balance-of-payment problem' is a pseudo-problem about which nobody need worry but a monopolist of the issue of money for a given territory. And not the least advantage of the disappearance of distinct national currencies would be that we could return to the happy days of statistical innocence in which nobody could know what the balance of payment of his country or region was and thus nobody could worry or would have to care about it.

The addictive drug of cheap money

The belief that cheap money is always desirable and beneficial makes inevitable and irresistible the pressure on any political authority or monopolist known to be capable of making money cheap by issuing more of it. Yet loanable funds made artificially cheap by creating more money for lending them, not only help those to whom they are lent, though at the expense of others, but for a while have a general stimulating effect on business activity. That at the same time such issues have the effect of destroying the steering mechanism of the market is not so easily seen. But supplies of such funds for additional purchases of goods produce a distortion of the structure of relative prices which draws resources into activities that cannot be lastingly maintained and thereby become the cause of an inevitable later reaction. These indirect and slow effects are, however, in their nature very much more difficult to recognise or understand than the immediate pleasant effects and particularly the benefits to those to whom the additional money goes in the first instance.

To provide a medium of exchange for people who want to hold it until they wish to buy an equivalent for what they have supplied to others is a useful service like producing any other good. If an increase in the demand for such cash balances is met by an increase of the quantity of money (or a reduction of the balances people want to hold by a corresponding decrease of the total amount of money), it does not disturb the correspondence between demand and supply of all other commodities or services. But it is really a crime like theft to enable some people to buy more than they have earned by more than the amount which other people have at the same time foregone to claim.

When committed by a monopolistic issuer of money, and especially by government, it is however a very lucrative crime which is generally tolerated and remains unpunished because its consequences are not understood. But for the issuer of a currency which has to compete with other currencies, it would be a suicidal act, because it would destroy the service for which people did want to hold his currency.

Because of a lack of general understanding, the crime of over-issue by a monopolist is still not only tolerated but even applauded. That is one of the chief reasons why the smooth working of the market is so frequently upset. But today almost any statesman who tries to do good in this field, and certainly anyone forced to do what the large organised interests think good, is therefore likely to do much more harm than good. On the other hand, anyone who merely knows that the success of his business of issuing money rests wholly on his ability to keep the buying power of his currency constant, will do more for the public good by aiming solely at large profits for himself than by any conscious concern about the more remote effects of his actions.

The abolition of central banks

Perhaps a word should be explicitly inserted here about the obvious corollary that the abolition of the government monopoly of the issue of money should involve also the disappearance of central banks as we know them, both because one might conceive of some private bank assuming the function of a central bank and because it might be thought that, even without a government monopoly of issue, some of the classic functions of central banks, such as that of acting as 'lender of last resort' or of 'holder of the ultimate reserve', might still be required.

The need for such an institution is, however, entirely due to the commercial banks incurring liabilities payable on demand in a unit of currency which some other bank has the sole right to issue, thus in effect creating money redeemable in terms of another money. This, as we shall have still to consider, is indeed the chief cause of the instability of the existing credit system, and through it of the wide fluctuations in all economic activity. Without the central bank's (or the government's) monopoly of issuing money, and the legal tender provisions of the law, there would be no justification whatever for the banks to rely for their solvency on the cash to be provided by another body. The 'one reserve system', as Walter Bagehot called it, is an inseparable accompaniment of the monopoly of issue but unnecessary and undesirable without it.

It might still be argued that central banks are necessary to secure the required 'elasticity' of the circulation. And though this expression has probably in the past been more abused than any other to disguise inflationist demands, we must not overlook its valid kernel. The manner in which elasticity of supply and stability of value of the money can be reconciled is a genuine problem, and it will be solved only if the issuer of a given currency is aware that his business depends on so regulating the quantity of his currency that the value of its unit remains stable (in terms of commodities). If an addition to the quantity would lead to a rise of prices, it would clearly not be justified, however urgently some may feel that they need additional cash—which then will be cash to spend and not to add to their liquidity reserves. What makes a currency a universally acceptable, that is, a really liquid asset, will be precisely that it is preferred to other assets because its buying power is expected to remain constant.

What is necessarily scarce is not liquidity but buying power— the command over goods for consumption or use in further production, and this is limited because there is no more than a given amount of these things to buy. So far as people want more liquid assets solely to hold them but not to spend them, they can be manufactured without thereby depreciating their value. But if people want more liquid assets in order to spend them on goods, the value of such credits will melt between their fingers.

No fixing of rates of interest

With the central banks and the monopoly of the issue of money would, of course, disappear also the possibility of deliberately determining the rate of interest. The disappearance of what is called 'interest policy' is wholly desirable. The rate of interest, like any other price, ought to record the aggregate effects of thousands of circumstances affecting the demand for and supply of loans which cannot possibly be known to any one agency. The effects of most price changes are unpleasant to some, and, like other price changes, changes in the rate of interest convey to all concerned that an aggregate of circumstances which nobody knows has made them necessary. The whole idea that the rate of interest ought to be used as an instrument of policy is entirely mistaken, since only competition in a free market can take account of all the circumstances which ought to be taken account of in the determination of the rate of interest.

So long as each separate issue bank in its lending activity aimed at regulating the volume of its outstanding currency so as to keep its buying power constant, the rate of interest at which it could do so would be determined for it by the market. And, on the whole, the lending for investment purposes of all the banks together, if it was not to drive up the price level, could not exceed the current volume of savings (and conversely, if it was not to depress the price level, must not fall short of the current volume of savings) by more than was required to increase aggregate demand in step with a growing volume of output. The rate of interest would then be determined by balancing the demand for money for spending purposes with the supply required for keeping the price level constant. I believe this would assure as close an agreement between saving and investment as we can hope to achieve, leaving a balance of change in the quantity of money to take account of changes in the demand for money caused by changes in the balances people want to hold.

Of course, government would still affect this market rate of interest by the net volume of its borrowing. But it could no longer practise those most pernicious manipulations of the rate of interest which are intended to enable it to borrow cheaply— a practice which has done so much harm in the past that this effect alone would seem an adequate reason why government should be kept away from the tap.

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