Book Review

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Denationalisation of Money: The Argument Refined (An Analysis of the Theory and Practice of Concurrent Currencies)
by Friedrich Hayek
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In the context of the Bretton Woods period, Hayek's critique to the Keynesian interventions to promote the expansion of the aggregate demand focuses on the error of not respecting the "spontaneous" economic order (Hayek, 1995). In his 1974 Nobel Prize speech, *The Pretense of Knowledge*, Hayek argued that the Keynesian recommendations to cure unemployment turn out to create patterns of resource employment that cannot be maintained without price instability and the disorganisation of the economic activity. He emphatically condemned the mistaken Keynesian policies. In his own words:

> "*The continuous injection of additional amounts of money at points of the economic system where it creates a temporary demand which must cease when the increase of the quantity of money stops or slows down, together with the expectation of a continuing rise of prices, draws labor and other resources into employments which can last only so long as the increase of the quantity of money continues at the same rate — or perhaps even only so long as it continues to accelerate at a given rate. What this policy has produced is not so much a level of employment that could not have been brought about in other ways, as a distribution of employment which cannot be indefinitely maintained and which after some time can be maintained only by a rate of inflation which would rapidly lead to a disorganization of all economic activity. The fact is that by a mistaken theoretical view we have been led into a precarious position in which we cannot prevent substantial unemployment from reappearing; not because, as this view is sometimes misrepresented, this unemployment is deliberately brought about as a means to combat inflation, but because it is now bound to occur as a deeply regrettable but inescapable consequence of the mistaken policies of the past as soon as inflation ceases to accelerate…*"

In truth, Hayek stated opposition to the Keynesian transformation of the discipline of economics. As of the 1970s, he condemned the role of the economists in promoting the engineering of social change through macroeconomic modelling. Under his view, for the Keynesian income expenditure model to work, the economist must know the aggregate level of current consumption, investment, and public spending, as well as the full employment level of output and the multiplier effect. As each step of the analysis presupposes that the detailed knowledge of economic life is available and that the outcomes of each policy intervention will have predictable effects on economic activity, he believed that the Keynesian macroeconomic policy was mistaken.

Considering this background, in *Denationalisation of Money: the Argument Refined*, Hayek proposed the abolition of the government monopoly over the issue of fiat money in order to prevent price instability. The Austrian economist clearly expressed his discontent with the recent history of the management of public money, mainly because of the orientation of Keynesian ministers of finance. In particular, he noted that the popularity of 'Keynesian' economics was due to the fact that:

> "*… Ministers of finance were told by economists that running a deficit was a meritorious act, and even that, so long as there were unemployed resources, extra government expenditure cost the people nothing, any effective bar to a rapid increase in government expenditure was destroyed*." (Hayek, 1976, p.118)

Hayek strongly emphasised the conflict between the two goals of economic policy: public finance and the regulation of a stable currency. For him, it is highly undesirable in any circumstances that funds for government spending should be provided by the creation of additional money. And he emphatically warned:

> "*If we are to preserve a functioning market economy (and with it individual freedom), nothing can be more urgent than that we dissolve the unholy marriage between monetary and fiscal policy, long clandestine but formally consecrated with the victory of 'Keynesian' economics*." (Hayek, 1976, p.117)

In addition, he highlighted that, on behalf of the *government monopoly of money*, central banks accommodate the financial 'needs' of government by keeping interest rates low and as a result central banks give their policies an inflationist bias. However, in his view, the use of money supply as an instrument for achieving particular ends turns out to destroy the equilibrating operation of the price mechanism and provokes major business fluctuations in a context of "unlimited democracy" in which government has the power to confer special material benefits to groups (Hayek, 1976, p.119).

At this respect, Hayek's underlying critique of Keynesian economics relies on the arbitrary interventions of the governments in the economic order since he underlined the difficulties of restraining the decisions and actions of the bureaucratic apparatus. Besides, he noted that the process of budgetary monetary financing is a self-accelerating process since this style of finance (the Keynesian style) turns out to create new expectations of further bounty. In Hayek's words: "*...One (process) which even men who genuinely wish to avoid it find it impossible to stop*" (Hayek, 1976, p.119).

The axle of the Austrian economist Friedrich Hayek's monetary theory contribution stimulates further discussion about the role of money and the challenges for the stability of the value of money. As a matter of fact, in the 1930s and 1940s, Hayek searched for systematic elaboration of the Austrian theories of capital, money, business cycles and comparative monetary institutions. As of the 1970s, in *Denationalisation of Money*, his theoretical critique disapproved the Keynesian foundations of economic stability. Indeed, Hayek condemned the Keynesian argument that government deficits are necessary to reduce unemployment. Under his view, although employment and price stability are not necessarily in conflict, priority should be given to monetary stability. A stable price level is, in principle, of central importance in ensuring that the three famous microeconomic functions which money provides are allowed to operate with maximum efficiency. Aware of the price stability challenges, he strongly highlighted the dangers that arise from monetary financing public spending in order to cure unemployment. In other words, the Austrian economist did not believe that the anti-cyclical government spending could mitigate any slackening of economic activity. Instead, in his opinion, what the Keynesian policy produces is a distribution of employment which can only be maintained for some time by a rate of inflation which would rapidly lead to a disorganisation of all economic activity. As a matter of fact, Hayek focused his attention on the role of the injections of amounts of money on the structure of relative prices and the consequent misallocation of resources and, particularly, the misdirection of investments. In this perspective, all inflation is called 'demand-pull' inflation.

In the case of such a complex phenomenon as the market, Hayek believed that neither macroeconomics nor microeconomics, although alternative methods of dealing with the market, provide a full explanation of the economic phenomena. In his view, macroeconomics attempts, such as the Keynesian attempt, by reference to aggregates or averages statistically available, give an unsatisfactory and sometimes misleading theoretical explanation of causal connections since this explanation asserts empirically observed correlations with no justification for the belief that they will always occur. Alternatively, the microeconomics approach – which he prefers – relies on the construction of models which cope with the problem by diminishing the number of independent variables "*to the minimum required to form a structure which is capable of producing all the kinds of movements or changes of which a market system is capable*" (Hayek, 1976, p.80).

In short, Hayek's *Denationalisation of Money* underlines that political interference over monetary policy and the maintenance of price stability are inherently incompatible to preserve economic freedom. He apprehended not only the nature of the overall transformations in capitalist societies after the Second World War but also identified the contemporary threatens to individual freedom. In fact, he restated the relevance of concepts and ideas proposed by the classical liberal philosophy in order to rebuild the foundations of constitutional governments to face the institutional decay in contemporary societies. Expressing concerns about the fragile contemporary institutional set up where the actions of central banks could have deep effects on individual freedom and social cohesion, Hayek points out the need to think about the institutional dimensions of society and the role of the economist in economic and social change.

Assessing the practical superiority of the free market dynamics over governments' discretionary interventions, Hayek believed that no government can know enough to effectively plan the future path of the economy and society. Moreover, central banks do not have the relevant information to correctly manage the money supply. As a result, central banks have disturbed the competitive mechanism of the market. His concern about the tendency of unlimited governments to grow indefinitely relies on the threats for future of capitalist civilisation. Hayek increasingly focused on the badness of the money supplied by governments to grant special benefits to particular interests. Considering the abuse of power, he suggested to deprive not only the government monopoly of issuing fiat money but also the government power of making any money 'legal tender' for all existing debts. The Austrian economist advocated the complete privatisation of money supply, as revealed by the views presented in *Denationalisation of Money*.

His defence of a complete privatisation of money supply stemmed from his disappointment with central banks' management, which, in his opinion, had been highly influenced by politics. In his view, despite the damages caused by inflation, the adoption of partial remedies for some of the symptoms, such as unemployment, would probably prolong and increase the inflationary process. The most conspicuous effect is observed in the whole structure of relative prices since its distortion provokes the misdirection of resources and factors of production (especially the investment of capital) into uses which remain profitable only so long as inflation accelerates. In the long run, the "Keynesian" attempts to accept wage and price rigidities as inevitable and to adjust monetary policy to them make the whole wage structure more rigid and, as a consequence, lead to the destruction of the market economy.

Hayek believed that economists do not have to play the role of political leaders but they must continue to point out that political interference over monetary policy and price stability turns out to be incompatible with social cohesion. At that time, Hayek's proposal of institutional reform relied on a denationalisation of money in the framework of a free market monetary regime where only those currencies that have a stable purchasing power would survive. His proposal of an institutional reform of the denationalisation of money would be achieved by the complete abolition of the government monopoly over the issue of fiat money. This proposal would leave the way open for a comprehensive privatisation of the supply of money.

The ultimate objective of the denationalisation of money advocated by Hayek was related to monetary policy independence from political interference. The basic idea is that the possibility of banks issuing different currencies would open the way to market competition. Banks could issue non-interest bearing certificates and deposit accounts on the basis of their own distinct registered trade mark and the currencies of different banks would be traded at variable exchange rates.

In *Denationalisation of Money*, Hayek underlines that the main advantage of the economic order is that prices will convey to the acting individuals the relevant information to make decisions to adjust their activities in face of the competition of currencies. Hayek underlined that there are four kinds of uses of money that would chiefly affect the choice among available kinds of currency: (i) for cash purchases of commodities and services, (ii) for holding reserves for future needs; (iii) in contracts for deferred payments, and (iv) as a unit of account, especially in keeping books. He was critical of the mistaken of thinking on different 'functions' of money instead of 'uses'. In his opinion, these uses are, in effect, consequences of the basic function of money as a medium of exchange. Only in exceptional conditions, such as a rapid depreciation of money, theses uses – otherwise interdependent – come to be separated from the function of money as medium of exchange. Indeed, the stability of the value money as a unit of account is the most desirable features of all the uses (Hayek, 1976, p.67).

Competition and profit maximisation would lead to market equilibrium where only the banks that pay a competitive return on liabilities to their clients could survive. Since currency corresponds to non-interest-bearing certificates, the crucial requirement is the maintenance of the value of the currency. Under Hayek's theoretical framework, the market forces would determine the relative values of the different competing currencies. In other words, the exchange rates between the competing currencies would float freely. So, in equilibrium, only currencies guaranteeing a stable purchasing power would exist. People would not want to hold the currency of an issuer that is expected to depreciate relative to one that is expected to hold its value in terms of purchasing power over goods and services. The marginal costs of producing and issuing a currency (notes and coin) are rather low (close to zero) and the nominal rate of interest would be driven (close) to zero.

Banks that fail to build up stability for the value of their currencies would lose customers and would be driven out of financial business.

Therefore, in the long run, a successful choice between alternative currencies for use in production and trade depends on the stability of the value of the currency in terms of commodities.[1] Aware that some prices always change in a free market, in *Denationalisation of Money*, Hayek proposed the idea of setting a standard set of wholesale prices of commodities to be treated as the standard of value in which people would prefer to have their currencies kept constant. As a result, currencies with value based chiefly on commodities important for particular occupations and habits, or for one group of predominant industries, might fluctuate relatively more against others (Hayek, 1976, p.76). In other words, the decisive factor that would create a general preference for a stable value in terms of commodities since this feature would make realistic economic calculation possible – or even, would make capital and cost accounting possible.

Despite the rejection of Friedman's monetary rule, Hayek said he was in complete agreement with Friedman on the inevitability of inflation under the existing political and financial institutional set up. For Hayek, money is not a tool of policy that can achieve particular foreseeable results by control of its quantity. Indeed, Hayek rejects Professor Friedman's proposal of a legal limit on the rate at which the central bank – as the monopolistic issuer of money – was to be allowed to increase the quantity of money in circulation in order to maintain price stability. The Austrian economist underlined that a stable price level and a high and stable level of employment neither require a constant total quantity of money nor changes of the total quantity of money at a constant rate. Indeed, only the market can discover this 'optimal quantity of money' that can be provided only "*by selling and buying at a fixed price the collection of commodities the aggregate price of which we wish to keep stable*" (Hayek, 1976, p.81).

In short, Hayek underlined that, without radical changes in the political and institutional framework, the inflationary process will lead to the destruction of the capitalist civilisation. Indeed, his proposal concerning money is part of a much more far-reaching reform agenda. He proposed two distinct although complementary reforms in the economic and the political order: the proposal of the monetary system may be possible only under a limited government and a limitation of government may require the end of its monopoly of issuing money.

As Kukathas recalls, Hayek started his intellectual life as an economist but turned his attention to political philosophy late in his career (Kukathas, 2012). Through his life, his thought developed in a more libertarian direction. Indeed, he defended a philosophy of liberalism as an antidote to the development of totalitarian regimes. In *Denationalisation of Money*, we can say that Hayek turned out to build a discourse on money and freedom.

If we follow the interpretation of Foucault (2010) on the foundations of the economic discourse, Hayek's theoretical contribution seems to be designed to show that the challenges to capitalist society could be overcome by political and institutional 'reforms'. Hayek replaced the conception of the economy as a domain of autonomous rules and laws by a concept of 'economic order' where the principles of competition and of the stable value of money are underlined. As a result, monopolisation is not some economic destiny, but the result of failed political strategies and inadequate forms of institutionalisation. At this respect, the government monopoly power of issuing money is also condemned. The question he faced was how governments could act on the basis of economic freedom since the freedom of individuals in competitive markets produces the legitimacy for a form of sovereignty that is limited to support economic activity.

Besides, Hayek highlighted that it is not capitalism which is responsible for the emergence of social problems. Under his understanding of the economic process, the unemployment and inflation challenges were not compellingly innate to the logic of capitalism but of a contingent historical nature. In other words, Hayek assumed that the survival of the capitalist system depends on political innovations. In his neoliberal discourse, there is nothing wrong with the "logic of capitalism" but with its institutions that are opened to political influences.

This classic book, *Denationalisation of Money*, is worth reading since the actuality of the debate is undeniable. Throughout the book, the reader faces the tensions that overwhelm the current challenges to the role of economists in society. Hayek's proposal aims to establish a deep distinction between his ideas on the free markets and the Keynesian policy recommendations since he believed that the Breton Woods' economic outcomes reinforced the menaces to social cohesion and justice in capitalist societies.

Why read the book of Hayek who is typically associated with those who defended the free market? The global crisis that began in 2007–08 has caused a re-examination of the ideas of Hayek in search of answers to the questions of what caused the crisis and how governments get out of it. On behalf of the current economic and social challenges, Hayek's reading is a must for academics, policy makers and politicians to engage in the discussion around free market vs. regulation; central banking and fiscal policy; austerity vs. growth policies. These topics are certainly urgent issues of current policy if we intend to promote a sustainable global order. Indeed, the book is worth reading since the lack of knowledge about Hayek's ideas has reinforced the ignorance of the disastrous social consequences of austerity as a political project in contemporary capitalism.

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