Chapter 13

THE FUTURE MONETARY UNIT OF VALUE

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Very few people will remember, or will have noticed, a footnote that appeared in *The Constitution of Liberty*, which I wrote twenty-one years ago. At that time, I said:

> Though I am convinced that modern credit banking as it has developed requires some public institutions such as central banks, I am doubtful whether it is necessary or desirable that they (or the government) should have a monopoly of the issue of any kind of money. The state has, of course, the right to protect the name of the unit of money which it (or anybody else) issues, and if it issues "dollars," to prevent anybody else from issuing tokens with the same name. As it is its task to enforce contracts, it must also be able to determine what is "legal tender" for the discharge of any obligations contracted. But there seems to be no reason at all why the state should ever prohibit the use of other kinds of media of exchange, be it some commodity or money issued by another agency, domestic or foreign. One of the most effective measures for protecting the freedom of the individual might indeed be to have constitutions prohibiting all peacetime restrictions on transactions in any kind of money or precious metals.[1]

This idea seemed to have been developing quietly in my mind, and sixteen years later, in growing despair about the continuing deterioration of the monetary situation, I threw out, almost as a bitter joke, the suggestion that, as things were developing, our only hope of ever

1. F. A. Hayek, *The Constitution of Liberty* (Chicago: University of Chicago Press, 1960), pp. 520–21.

again having good money probably required that we take from government the monopoly of issuing money and hand this task over to private enterprise. Once seriously examined, this proved to be a more and more attractive idea and it finally appeared to me as the only definite solution to the increasingly hopeless position we were encountering with monetary conditions everywhere. I then systematically expounded the concept in *The Denationalization of Money*, a second, expanded version of which was published in 1978.[2]

My proposal would entitle private concerns to define and create new monetary units of their own choosing and to issue liabilities denominated in these units. The public would be allowed to hold such moneys in whatever amounts they chose and to make contracts for payment in terms of whatever moneys they chose. I now intend to consider how such a system could be brought about.

DESIGNING A NEW MONETARY ORDER

In endeavoring to design a better monetary order, we at once encounter the difficulty of not really knowing what we want. What would be a really good money? Not the least harm the immemorial and nearly universal government monopoly of the issue of money has done is to deprive us of the chance to find out experimentally what kind of money would really serve us best. To the present day, money is that part of the market order that government has most suppressed. It is also the part of the market order that silly rulers and economists have most tinkered with. Yet neither economists nor politicians invented the market, though some have come to understand it a little, and it will not be present knowledge but discoveries by free experimentation that can show us the best solutions.Those who needed money chiefly as an indispensable tool of trade, and who first discovered it as a means for making most trade possible, were soon forced to use what government gave them. And government jealously guarded its monopoly, for purposes quite different from those for which money had been introduced.

Since ancient times, governments have claimed an exclusive right over coinage. The very word "seigniorage," used to denote the fee

2. F. A. Hayek, *The Denationalisation of Money*, 2d ed. (London: Institute of Economic Affairs, 1978).

governments have charged for minting coin, signifies that coinage was considered an exclusive right of the sovereign. And even in England it was an open question whether the monarch had a legal right openly to debase the coinage in order to raise revenue.[3]

Today money is chiefly not an effective medium of exchange but a tool of government for fleecing us and for "managing" the economy. As a result, we are obliged to admit that we have little empirical evidence of how the various conceivable methods of supplying money would operate and almost none about what kind of money the public would select if it had an opportunity to choose freely between several different and clearly distinguishable kinds of money. For this we must rely largely on our theoretical imagination and try to apply to a special problem that understanding of the functioning of competition that we have gained in other fields.

In justification of its monopoly, government could, of course, argue that a single uniform kind of money used in all transactions constitutes such an advantage that it is worth sacrificing potential improvements. A single unit of account in which all prices are quoted and in which all units of currency and all financial assets are denominated is undoubtedly a great advantage. Yet it is questionable whether this excuse can still be accepted once we recognize how much avoidable harm is done by the kind of money we now have. And certainly a major reason for not having better money is that there has not been enough experimentation to lead to agreement about what kind would be desirable. Selective evolution was cut off by authority before we had a chance to explore adequately the different possible solutions of the problem. That, surely, was too high a price to pay for what may have been a temporary convenience.

The basic contention on which the validity of my further argument rests is that if people were wholly free to choose which moneys they wished to use in their daily transactions, those would do best who preferred a money with a stable purchasing power. Such a money would, therefore, be most likely to emerge from monetary experimentation and evolution. Sixty years ago I began my work on monetary theory by questioning the belief, then universally accepted, that the purchasing power of money should be kept stable. I then suggested that it was more desirable for the purchasing power of

3. F. W. Maitland, *The Constitutional History of England* (Cambridge: Cambridge University Press, 1908), p. 260.

money over consumer goods to increase over time.[4] But I have since become convinced that a money of stable value is really the best we can hope for. If the value of money were stable, then the price of any commodity about which we have no special information would be as likely to rise as to fall; on balance the unforeseen price changes would just offset each other. If the level of average prices were stable, then a rise (or fall) of the money price of any commodity would also indicate a rise (or fall) in price relative to most other commodities. A rise in price could not occur, as it often does today, if the commodity had actually become relatively cheaper than most other goods whose prices had increased more. This advantage of a stable money over all unstable ones would be particularly significant for the calculations of enterprise but hardly less so for the holders of employment contracts and for savers. A stable measure of value would eliminate much of the uncertainty that everyone holding a contract stipulating future payments is now compelled to bear. And the important consequences of an availability of different currencies would be not only that people would prefer to make contracts in terms of a currency they could trust, but even more that, though they might be ready to accept any currency for payment for their goods, they would not wish to hold, and indeed would rapidly exchange, any currency they did not trust into one they did. This would very quickly either wholly drive out any currency whose issuers did not keep its purchasing power constant, or at least force its issuers at once to alter their policy as soon as even a slight discount of their currency's value showed itself in the market.

This may at first appear to be in conflict with the so-called Law of Gresham, which says that "bad money drives out the good" (a concept known to the ancient Greeks more than two thousand years ago). But it is a misunderstanding of Gresham's Law to believe that the tendency for bad money to drive out good money makes a government monopoly necessary, even though the distinguished economist W. S. Jevons stated the law in the form that better money cannot drive out worse precisely to prove this. What Jevons and so many others seem to have overlooked is that Gresham's Law applies only to different kinds of money between which a fixed exchange rate is enforced by law. If the law makes two kinds of money perfect sub-

4. F. A. Hayek, *Monetary Theory and the Trade Cycle* (London: Jonathan Cape, 1933), pp. 114ff.

stitutes for the payment of debts, and forces creditors to accept a coin of a smaller content of gold in the place of one with a larger content, debtors will, of course, pay only in the former and find a more profitable use for the substance of the latter. With variable exchange rates, however, the inferior quality money would be valued at a lower rate, and people would try to get rid of it as quickly as possible, particularly if it threatened to fall further in value. The selection process would go on toward whatever they regarded as the best sort of money among those issued by the various agencies, and it would rapidly drive out money found inconvenient or worthless.

Indeed, whenever inflation has become really rapid, all sorts of objects of a more stable value, from potatoes to cigarettes and bottles of brandy to eggs and foreign currencies like dollar bills, have come to be increasingly used as money; so that at the end of the great German inflation, some contended that Gresham's Law was false and the opposite true. It is not false, but it applies only if a fixed rate of exchange between different forms of money is enforced.[5]

I have not space here to consider the reasons why, almost since coins were first introduced more than two and a half thousand years ago, governments have invariably abused their monopoly shamelessly,[6] to the grave damage of people at large. Nor have I space to explain in detail why the international gold standard, which for a short period in the past provided us with better money than we ever had before or have had since, can in fact not be restored in an effective form.[7] Thus, completely depriving governments of their power over money has by now probably become easier than attempting to prevent them from abusing that power.

If governments were deprived of their power over money, private firms would quickly begin to define new monetary units and to issue liabilities denominated in terms of these units. Competition among issuers would compel them to seek to define their units in ways most useful to the public and to make them available to the public at the most attractive feasible terms.

5. Hayek, *Denationalisation of Money.*

6. With the exception only of the short periods during which they divested themselves of discretion by making a fixed quantity of one of the precious metals the legal unit.

7. To restore the gold standard would, in brief, require a return to beliefs that have been destroyed, and to do so would probably cause such fluctuations in the value of gold that the standard would break down before long.

DEVELOPING AN INTERNATIONAL MONETARY UNIT

A primary objective of any monetary system must be to keep the world economy functioning efficiently. Since to do so we clearly need some international standard, and since we can obtain current information about the international price system only from the wholesale prices of the more widely traded standardized raw materials, the closest approach to a general stability of the purchasing power of a monetary unit would probably be the stabilization of an index number of the prices of these raw materials. Competing issuers would no doubt offer a number of competing monetary units, defined in terms of alternative collections of commodities, whose values they would pledge to stabilize. The public would thus have the opportunity to select the most useful monetary standard as well as the most efficient and reliable issuers of money. The issuer of a new monetary unit could make the money unit redeemable in such amounts of other currencies as would be required at any time to buy the whole collection of different raw materials defining the standard unit. Such a commitment would effectively stabilize the value of the issuer's money unit in terms of the particular collection of raw materials defining the standard unit. Any difference in value between the monetary unit and the standard unit would create opportunities of arbitrage that would at once restore equality between their values.

Of course, neither the composition nor the weights attached to each of the different commodities could be kept constant indefinitely. The issuer would have to have the option of changing the list of different commodities and the weights attached to each as their importance in trade changed. The issuer would have to assure the holders of the units—in order to protect them against concealed changes in value—that at the moment of any change, the aggregate value of the new basket of commodities, at current market prices, would be the same as that of the old basket (and, probably, that for a limited period, holders of the units would have the choice of demanding redemption in terms of the new basket or the old).

Any such new international unit provided by a particular issuer would, of course, have to have a distinct name, and for the purposes of this discussion I will call it a "Solid." The success of such an experiment might well depend on the persuasiveness and suitability

of the name chosen. I must confess that I have thought of a much more attractive name, indeed one that would probably be worth millions. But since I have had legal advice that a protective trademark (or copyright protection) can be obtained under current law only by persons or firms actively dealing in the article in question, I have no choice but to keep it secret for the time being. So, as second best, I will use the name "Solid" in describing my scheme for a privately issued monetary unit that, I believe, might (in spite of the inevitable resistance of government) well be introduced—though at first not as circulating tokens but as transferable deposits redeemable in the current kind of hand-to-hand money or tokens that for the time being governments will probably not allow private agencies to issue.

Though the different credit units of this kind would of course all have to bear different names and might at first represent different collections of commodities, after a period of competitive experimentation, most or all that survived would probably keep constant value relations to each other, even if the units were of different magnitude. Once the advantages of such units with stable buying power were generally recognized, and once some suppliers had demonstrated their ability to maintain the value of their units and had thus established a flourishing business depending wholly on maintaining this trust, such a system would be preserved because any supplier of such stable credits who failed to maintain their value would be rapidly driven out by a mass flight from the unstable money.

OFFERING CREDIT ACCOUNTS IN A STABLE UNIT

I had originally visualized that, from the beginning, the suppliers of private moneys would provide them not only in the form of book credits but also in the form of corresponding notes or tokens for fractional values. But although years of further reflection on the problem have only confirmed my belief that this ought to be the final solution of our money problems—and is the only way we will ever again get back to honest money while at the same time ridding ourselves of the evils of crisis, depressions, unemployment, and general disorganization of the market—I cannot close my eyes to the fact that any hope for a voluntary abdication by governments of their present monopolies of the issues of circulating currency is uto-

pian. Governments have become dependent on their power to create money for financing their own activities, since it allows them to spend in excess of the revenue they can obtain from honest taxation. They also regard their control over money as so essential a weapon of their economic policy that they will probably defend to the last not merely all the explicit powers the law has conferred upon them, but also any others they can obtain. Though it may be doubtful whether many governments actually possess a constitutional right to prohibit the private issue of an alternative circulating money, there can be little doubt that they could, through the manipulation of such rules as those of legal tender, prevent any attempt in this direction from being successful.

But under present conditions, this applies only to currency or hand-to-hand money, that is, to pieces of paper or tokens passing physically from person to person as a general medium of exchange. We are still used to regarding this as the basic money, through which most of today's trade—dependent on expression as a multiple of some such units of hand-to-hand money—is transacted. This is, however, a misleading impression. The exclusive right to issue the tokens that serve as legal tender for the discharge of obligations contracted in terms of them does not preclude the use of credit accounts in other units as a general means of exchange. Transactions could easily take place by the transfer of funds from the account of one individual to the account of another just as they occur today in the vast number of cases. The difference would be that the accounts would be denominated in terms of monetary units over which governments had no control and which, therefore, would be likely to maintain a constant value. At least where no foreign exchange restrictions are in force—and even these presumably restrict only transactions in specified amounts of named national currencies—general laws do not seem to prohibit the keeping of accounts entitling creditors to receive on demand such amounts of other moneys as at the time would enable them to buy at current market rates a corresponding part (or multiple) of the basket of raw materials defining the unit in which the account is kept.

I am now coming to the crucial problem: Would it be possible and profitable for a banking institution to offer such accounts, denominated in Solids, Ducats, Stables, or whatever the name might be, which it would undertake to redeem on demand with such amounts of the various other currencies as would be required to buy on the

established commodity exchanges the stated collection of the various raw materials whose aggregate value defined the unit in question? The difficulties of the task derive from the circumstance that in order to maintain any particular value of the unit, the bank must stand ready to buy or sell at the stated rates *any* amount of such units that might be offered to or demanded from it.

The only control the bank could exercise would be through lending and borrowing (i.e., creating and extinguishing such deposits) at different terms, that is, by altering the rates of interest it charged its borrowers or paid its depositors or by altering the service fee it charged for running these accounts. Providers of such accounts would, of course, have to be constantly aware that they had no control over the total amount of such liquid assets available to the members of the community or to the inhabitants of any clearly delimitable region. The total amount of such assets available to the public would depend on the ability of competing financial institutions to provide such assets in the amounts demanded by the public. The aim of any single institution would be to offer, in competition with other institutions, a clearly distinguishable asset desired by the public as a liquid reserve because it was trusted to preserve its value. This assurance could be offered only by standing ready, at all times, to redeem these deposits by the "cash" actually needed to buy the designated collection of raw materials. Yet, if a number of separate institutions succeeded in supplying their clientele with differently named but equivalent amounts of fully liquid units of media of exchange at market prices, then in terms of any one of these units, the general price level of commodities would remain stable.

Could any individual bank control the volume of its on-demand commitments so that it would at all times be able to deliver instantly the amounts of other currencies sufficient to buy at market prices the stated collection of commodities? The chief difficulty would arise from the fact that if it were to prevent the value of its unit from rising *above* the announced level, it would have to be prepared to accept any amount on deposit that might be offered to it at the announced terms. In other words, the public might well find the new unit so attractive that—unless its supply could be rapidly expanded to meet the public's demand to hold the unit—its value might appreciate above the value of the standard unit in terms of which it was defined. Such a premium would reflect the public's confidence that the purchasing power of the new unit was more likely to be main-

tained than the purchasing power of other currencies. To control the volume of its on-demand commitments in order to ensure a stable value for its unit, the individual bank would have to be prepared to accept any amount on deposit that was offered to it at the announced terms—that is, at the buying and selling prices of its own unit in terms of other currencies and the interest it paid or the service charge it imposed for maintaining such deposits. Accepting any amount on deposit that was offered might at times create the difficult problem of finding sufficient opportunities for investing these amounts in assets that were themselves likely to preserve their value. For controlling such fluctuations in the demand for its deposits, the bank would in effect have only two instruments. First, it could vary the difference between the buying and selling prices of its own unit in terms of other kinds of money. For example, if it took $2 to buy the standard unit that defined one Solid, and the bank maintained the same buying and selling prices of Solids in terms of dollars, the bank would create Solid accounts at the rate of 0.5 Solids for every dollar deposited and would pay out dollars from such accounts at the rate of 0.5 Solids per dollar as long as the purchasing power of the dollar in terms of the standard unit did not change. But if the bank found that the demand for Solid accounts was greater than it could supply, it could reduce the demand for Solid accounts to its capacity of providing them by raising the selling price of Solids; for example, while creating Solid accounts at the rate of 0.5 Solids per dollar, the bank would only convert the Solids back into dollars at the rate of 0.55 Solids to the dollar. The second instrument the bank could use would simply be to reduce the interest it paid on deposits or to increase the service charge it imposed for maintaining them.

It is clear that banks will have much to learn before they can be certain that they know how to deal successfully with these tasks. To be able to provide millions with their liquidity reserves, and to earn the interest they would have to earn in order to pay interest on the funds thus deposited with them, could well prove the greatest banking success ever for those who first solve these problems. I would gladly wish the highest gains to those who succeed in conferring on the world the inestimable benefit of at last providing a medium of exchange through which markets could function as well as they should be able to function. And if such a stable money were established—though it would exist under many different denominations

and trademarks, with each kind issued under the name of, and with the responsibility assumed by, a different institution—the successful suppliers could probably not for any length of time be denied the right to issue corresponding tokens representing fractional units. At least locally, because of their fixed relation to the basic credit unit, such fractional units would soon displace the traditional "official" cash. And before long, governments would probably learn to insist that their taxes be paid in the new stable units—an event that would constitute the final victory of the system.

The second point is that, once credit accounts in a stable unit are provided by some institutions, governments could hardly prevent the development of *credit cards* that, with the consent of both parties, instantly converted the amount due in a local currency into its equivalent, at the current rate, of a stable unit. Debtor and creditor would know that a certain amount of purchasing power would be due by or to them within a fixed period. Although governments would probably long resist the use within their territory of any hand-to-hand money other than their own, they could hardly long prevent such a use of credit cards. I have little doubt that as soon as such stable private units were available, the issuers of credit cards would be well advised to use them. Indeed, I believe that it will be through the credit card rather than through any kind of circulating token money that the government monopoly of the issue of money will ultimately be broken. It is a money governments cannot confiscate when it is carried across frontiers and scarcely even when claims in terms of it are held by the recipient. The permissibility of the use of such credit cards for payments in terms of a stable unit would probably soon become the passport for access of a country not only to international tourism but also to international trade. Few countries would long wish to exclude their citizens from the profitable business of offering credits in stable units.

It is a different question whether it would be advisable for the issuers of credit cards themselves to enter into the business of offering such stable credit accounts. This might make it more difficult, if not even impossible, for them to control the total volume of such deposits effectively enough to secure the constant value of their units. This question will have to be carefully studied by people who understand the mechanism of the credit card business better than I do.

ASSURING STABILITY OVER TIME

Of the many other consequences, some of which I deal with more fully elsewhere, I will here consider at greater length one that I had initially not even perceived but that now appears to be the most important. It seems to me that the emergence of a new stable international unit of value not dependent on the arbitrary will of anybody would have hidden far-reaching effects. If throughout the world there were a large number of nominally different monetary units, all maintaining themselves in circulation only so long as they preserved the same value as most others, the collapse of any one of them as a result of malfeasance or mistaken policies would not do as much harm as the collapse of any currency does today. The holders of balances of a currency that lost part or all of its value would, of course, lose all that, just as they do today. But the greatest losses caused today by the devaluation of a currency are not those to the individuals actually holding amounts of that money but to those who have contractual claims expressed in terms of it. As I have explained:

> With the availability of at least some stable currencies, the present absurd practice of making 'legal tender' a mere token which may become valueless but still remain effective for the discharge of debts contracted in what has been an object of a certain value, is bound to disappear. It was solely the power of governments to force upon people what they had not meant in their contracts that had produced this absurdity. With the abolition of the government monopoly of issuing money, the courts would soon learn to understand, and I trust also statute law soon provide, that justice requires all debts to be paid in terms of units of value which the contracting parties intended, and not in what government decrees made a substitute for them. After the development of a widely accepted common standard of values, the courts would have in most cases no difficulty in determining the approximate magnitude of the abstract value intended by the parties to a contract by the value of such and such an amount of a widely accepted currency. If a currency in terms of which a contract had been made depreciated seriously beyond a reasonable range, a court would not allow the parties to gain or lose from the malpractice of a third party that issued the currency. They would be able without difficulty to determine the amount of some other currency in which the debtor was entitled and obliged to discharge his obligation.
>
> As a result, even the complete collapse of one currency would not have the disastrous consequences which a similar event has today. Though the holders of cash of a particular currency either in the form of notes or of demand

> deposits might lose the whole value, this would be a relatively minor disturbance compared with the general shrinkage or wiping out of all claims to third persons expressed in that currency. The whole structure of long-term contracts would remain unaffected, and people would preserve their investments in bonds, mortgages and similar forms of claims, even though they might lose all their cash if they were unfortunate enough to have used the currency of the institution that failed. There could never occur such a complete disappearance of any common standard of debts, or such wiping out of all monetary obligations, as has been the final effect of all major inflations in the past. Long before this could happen, everybody would have deserted the depreciating unit, and no old obligation could be discharged in it.[8]

Above all, however, such a semiautomatic regulation of the supplies of the main kinds of money, assuring the stability of their purchasing power, would eliminate the causes of the alternation of inflationary booms and periods of depression and unemployment that have plagued societies ever since deliberate attempts at a central control of the quantity of money were made.

To sum up, the money we now have is not a fully fledged product of the process of cultural evolution, but a kind of deformed child that has suffered from being forced to pass through unduly restricted channels and has thus been kept from realizing its potential. It has been made to serve purposes to which it is not adapted. People will still have to discover that money is neither a suitable tool of economic policy nor an instrument that government can honestly use to secure greater means than the people are prepared to grant it. Money is an imperfect link in the self-steering mechanism of the market. We must learn how to make that link more effective.

8. Hayek, *Denationalisation of Money*, pp. 124–25.

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