Hayek on Money

Sarah Hynes – Senior Sophister

Sarah Hynes examines the economic theories of Freidrich Hayek. The author examines the debate between Hayek and Keynes in the 1930's and the triumph of Keynesianism. She then turns to the re-emergence of Hayek's theorising in the 1970's, and concludes that Hayek's contribution to monetary thought was unrecognised by the mainstream.

Introduction

Friedrich August Hayek was born in Vienna 1899 and died in 1992. Though his life roughly coincides with the twentieth century, quite the opposite may be said about his economic theorising which was almost always in conflict with mainstream thought throughout his life. His life-long pre-occupation with inflation was a driving force behind his clash with Keynesian interventionism in the 1930's and the aggregative positive economics of Milton Friedman and the monetarists more recently. Hayek's appointment as Tooke Professor in Economic Science and Statistics in the London School of Economics in 1931 was a manifestation of his pre-eminent position in economic thought in the 1930's. J. M. Keynes and Piero Sraffa abruptly cut the promising start short by denouncing his interpretation of the business cycle in a debate in the 1930's.

He then turned his attention to epistemology, philosophy, politics, psychology and law, leaving London in 1950, for Chicago and then returning to Austria. His work in these areas was decisive in the intellectual battle against communism in the twentieth century. This won him admirers who included Margaret Thatcher. The Thatcher connection and Hayek's later work advocating radical free market policies has meant that he is often relegated to the extreme right-wing of economic thought. The fall-from-grace of Keynesian economics in the 1960's and 70's as well as the conferment of the Nobel Prize for economics on Hayek in 1974 has led to a resurgence of interest in his work.

This essay is divided into two parts. The first focuses on the debate between Hayek and Keynes and Sraffa in the 1930's. This debate is interesting from the point of view of the economic historian because it is a turning point in economic thought, preceding the

Keynesian revolution that changed the course of events in the twentieth century.

The second part deals with Hayeks' return to economic theorising in the 1970's with regard to his radical plan for the denationalisation of money, sparking off a debate on the topic. The evolution of his thought and the incorporation of some of his ideas developed in the intervening years are evident.

The Keynes-Hayek-Sraffa Debate of the 1930's

'Hayek's economic writings... are almost unknown to the modern student; it is hardly remembered that there was a time when the new theories of Hayek were the principle rival to the new theories of Keynes' (Hicks, 1967: 203).

The misunderstandings which characterised the debate have been attributed to the obvious fact that Hayek and Keynes/Sraffa represented respectively two different economic traditions, namely the Austrian School of Economics and the Cambridge School, and also the two rival institutions of LSE and Cambridge University. As Kurz (unpublished: 2) puts it '*The quest for truth competed with other motives including the desire to win out against alternative schools of economic thought and establish a dominant position in economics'*. The victory undoubtedly belonged to Keynes and the Cambridge tradition. By the mid 1940's Hayek had retreated from academic economics, turning his attention to the epistemological and political writings for which he is more renowned among the general public.

The relevant primary literature expressing Hayek's views consists primarily of two books; *Prices and Production* (1931), and *Geldtheorie und Konjunctutheorie* (1929), published in English as *Monetary Theory and Trade Cycles* (1933). Hayek's review of Keynes's *Treatise on Money* (1930), published in *Economica* sparked off the debate between Keynes and Hayek. Sraffa's highly critical review of *Prices and Production* appeared in *The Economic Journal* in March 1932. Hayek's reply was published in June of that year along with Sraffa's rejoinder.

The dispute began when Lionel Robbins asked Hayek to review Keynes's *Treatise on Money* (1930). The "scathing attack" by Hayek appeared in the November 1931 issue of the LSE household journal *Economica*. *'The exchange led to a heated correspondence*

between Keynes and Hayek from December 1931 to February 1932 ... including a letter from Hayek to Keynes on Christmas day with a reply the same day' (Dimand 1988: 57 quoted in Steele 1996:131). The intensity was short lived. Keynes's disengagement, as he shifted his attention to other subjects and ultimately to writing the *General Theory,* resulted in a *'grave disappointment'* to Hayek (Wubben, 1997: 197). Hayek declined from engaging with this *'erratic person as he came to characterise Keynes'* (Wubben, 1997: 198), not bothering to review his *General Theory* in 1936.

The substance of the debate was *'the self adjusting and co-ordination properties of a market economy'* (Butos, 1994: 470 in Wubben 1997: 197). The debate essentially centred on savings and investment. Keynes and Hayek had a common starting point in Wicksell's distinction between a natural and market rate of interest, the former denoting the notional value where planned savings equals planned investment, and the latter actually determined by the demand and supply of loanable funds. A divergence between the two generates a cumulative process of price changes until the economy returns to equilibrium (Tieben 1997: 98). From this common starting point, as Hicks points out, *'Wicksell plus Keynes said one thing, Wicksell plus Hayek said quite another'* (Hicks, 1967: 204). From that point on their theories diverged significantly. Keynes defined the discrepancy between ex-post savings and investments as unanticipated profits. The role of expectations is central to Keynes's analysis where they are frustrated/satisfied when savings exceed/match investments, resulting in a steady state contraction, with no endogenous self-correcting mechanism. Hayek attributed the divergence to intertemporal unwinding of monetary disturbances within the framework of Austrian Capital theory. Hayek maintained that the business cycle is a problem of a monetary economy where co-ordination failures between firms and households lead to a boom and bust scenario due to the disturbing influence of the banking system (including both the monetary authorities and banks in general).

The methodological differences between the two men also contributed to the confusion characteristic of the debate. Hayek avoided mathematics on principle, meaning he had to resort to complicated and sometimes ambiguous verbal explanation and his infamous triangles to explain complex phenomena. At this stage he was still an adherent of Walrasian General Equilibrium, in his own words *'most perfectly expressed by the Lausanne school'* (Hayek, 1933a: 42) which he attempted to integrate with his business cycle theory. Hayek viewed Paretian equilibrium as the centre of gravity toward which

all major economic forces tended.

To a large extent the review consisted of a criticism of the terminology used by Keynes. '*By arbitrarily changing the meaning of familiar concepts, Mr Keynes has succeeded in making plausible a proposition that nobody would accept were it stated in ordinary terms*' (Hayek 1932a: 73). Tieben (1997), points out that Hayek was perhaps too eager to undermine an argument that was anathema to his own, thus ignoring the main theoretical innovation of the *Treatise,* that is the influence of stocks of assets as well as flows on the interest rate. Keynes acknowledged the possibility of investment in other financial assets besides new Capital goods. Hayek recognised that Keynes's portfolio balance approach was '*in many respects the most interesting part of his theoretical analysis*' (Hayek, 1932a: 75) but ignored it from then on. Keynes also explicitly recognised the store of value function of money whereas Hayek exposed himself to criticism in only considering the means of exchange function. The focus of criticism on the terminology may have also reflected Hayek's objection to Keynes's overly aggregative style of theorising (Foss, 1999: 25).

On a theoretical level, Hayek's criticism of Keynes centred on Keynes's neglect of the structure of production processes and his concentration upon purely monetary effects. In fact Keynes's business cycle theory did lack capital theoretic foundations, however it is unlikely he would have found much use in Austrian Capital theory to rectify the situation. Keynes and Hayek both ignored certain aspects of each other's work, leading to the conclusion that had there not been a lack of communication, both theories could have been improved. Both economists were guilty of judging each other's works by the yardstick set by their own theories. Most recent commentators concede that the two men were talking at cross-purposes. Nentjes (1989: 143 in Tieben 1997: 96) goes as far as to contend that the debate was '*a clash of two opposing paradigms and its accompanying lack of communication*'. This explains why much of the debate involved disagreements about terminology and why it degenerated to some quite hostile and even offensive discourse. Keynes complained that '*Hayek has not read my book with that measure of 'good will' which an author is entitled to expect of a reader. Until he can do so, he will not see what I mean or know whether I am right. He evidently has a passion which leads him to pick on me, but I am left wondering as to what that passion is*' (Keynes, CW XIII 243 quoted in Kurz unpublished: 22). Keynes then turned his attention to other subjects, leaving Piero Sraffa, his colleague at Cambridge to continue the battle to discredit

Austrian Economics.

At almost the same time as the Hayek-Keynes macro-debate, Piero Sraffa was asked by Keynes to review *Prices and Production* for the *Economic Journal.* The book was the result of a series of four lectures at the LSE that Hayek had given in 1931. The reaction in Cambridge was one of confusion. Kahn (1982: 82 quoted in Steele 1996: 131) recalls that Hayek had completely bewildered his audience by his presentation of a condensed version in a paper to the Marshall Society. Kahn also recalls that there was an impression at the time that he was being '*served as an antidote to Keynes'*.

It should be noted that at this stage of the debate, Hayek had only been in London less than a year and that most contemporary economists were unfamiliar with his previous work or indeed with continental economic thought, in particular Austrian Capital theory. Many economists looking on from the sidelines were baffled by the debate. In Hicks' words '*Prices and Production was in English but it was not English economics*'. Hayek's triangles, which he used to explain intertemporal allocation of resources between intermediate producers' goods and consumers' goods, continue to confuse to this day. An in-depth analysis of the theory expounded by Hayek's *Prices and Production* is beyond the scope of this essay. A few points of interest must suffice.

The book has two aims; the first constructive and the other critical. Hayek seeks to refute previous theories which, in the first lecture, '*Theories of the Influence of Money on Prices'*, he classified in four stages. His four stages track a development from Locke, Cantillon, Hume, Ricardo, and Wicksell among others. The fourth and final stage has yet to come to fruition (but will presumably encompass his own work on monetary theory). Sraffa approvingly refers to it as '*a model of clearness*' (Sraffa, 1932: 42). With the introduction of Böhm Bawerks Capital theory, Sraffa's approval disappears. The constructive aim of the book is addressed in the remaining three lectures which integrate capital theory with monetary theory addressing issues concerning prices (relative prices and the general price level), credit, savings and investment. He concludes in the last lecture with some prescriptions for monetary policy. Hayek emphasises the importance of relative prices rather than the general price level reflecting his dislike of aggregation using statistical methods to empirically verify economic theory. He proposes instead to adopt an individualistic method consistent with his own methodology of subjectivism.

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The notion of equilibrium adopted by Hayek was different to that adopted by Sraffa and Keynes. Hayek saw business cycles as a transitional stage between equilibria. It was the time dimension that distinguished Hayek's notion of intertemporal equilibrium from Keynes's more limited Marshallian concept of equilibrium. Hayek conceived the interest rate as inherently an intertemporal relative price which '*expresses itself in the whole structure of relative prices*' (Hayek, 1933a: 207 in Foss, 1999: 36). The concept of "forced saving" occupied a prominent position. In an economy where resources were fully utilised, further investment may only take place if a smaller amount of output is consumed. Unlike Keynes, it was the world of fully-utilised resources that Hayek occupied. Throughout the book Hayek maintained that '*the recurring business depressions can only be explained by the operation of our monetary institutions*' (Hayek, 1931: 111). Forced Saving is brought about artificially by banks lending to producers at a more favourable rate. An increase in the production of capital goods relative to consumer goods due to a change in the propensity to save leads to a new equilibrium. However, an increase in production financed by credit forces consumers to save since the production of consumers goods has been reduced. This disequilibrium scenario, reflecting the upswing in a business cycle, is re-equilibrated by a change in the relative price structure where some specific capital (e.g., specialist machinery) cannot be easily reverted to consumption. Hayek sees the case of voluntary saving as '*permanent and justified*' whereas in the case of forced saving there are distributional effects where '*now this sacrifice is not voluntary and it is not made by those who will reap the benefits of those investments*' (Hayek, 1931c 52-53).

An exert from the passages on forced savings shows how Hayek's perception of the economy differs from Keynes:

'The existence of unused productive capacity is therefore nothing less than a proof that capital is available in abundance, whereas consumption is insufficient: Quite on the contrary, it is a sign that these productive capacities cannot be used, because the current demand for consumption goods is too urgent to allow us to invest the available productive resources in time consuming processes of production.' (Hayek, 1931c: 94).

In his *General Theory* Keynes relegated two of the central issues of Hayek's theory, namely neutral money and forced saving to '*a theoretical limbo from which they have never returned*' (Foss, 1999: 37).

The neutrality of money was a recurring theme. Hayek was critical of monetary policy guided by the '*widespread illusion that we only have to stabilise the value of money in order to eliminate all monetary influences on production*' (Hayek, 1931c:126). Hayek saw money as neutral in a monetary economy only when events took place '*as if they were only influenced only by the real factors*' (Hayek, 1931c: 130). This did not necessarily mean, as Sraffa interpreted, to maintain the MV in the Quantity Theory of money as constant. Hayek recognised that even though a change in the quantity of money may or may not have an impact on the general price level, it almost certainly effects the structure of relative prices. It is this relative price structure upon which production depends.

Hayek saw neutrality as a theoretical concept, which could not be achieved by a simple stratagem of monetary policy. He was strongly opposed to an elastic currency fluctuating with the level of production. He likened the system of credit to an inverted pyramid, where the lowest part corresponded to cash, the next tier up, was central bank credit, then commercial bank credit, then private credit. Since only the first two or three tiers could be officially controlled, it would be extremely complicated and difficult to maintain a constant velocity of circulation. In terms of policy prescription Hayek had very little to offer. In contrast, Keynes provided a practical programme to escape the Great Depression. Maintaining the MV in the Quantity Theory of money constant was the second best solution since in the real world the conditions necessary for neutral money would never exist. Therefore, according to Hayek:

'*The only practical maxim…Is probably a negative one that the simple fact of an increase of production and trade forms no justification for an expansion of credit, and that –save in an acute crisis- bankers need not be afraid to harm production by over caution*' (Hayek, 1931c: 125)

There are some aspects of Hayek's theory that are relevant to events today. The idea of malinvestment or misdirections of production to explain the business cycle has some relevance to the booming US economy in the late 1990's and the subsequent slowdown due to overinvestment in Information Technology as, in Hayek's words, '*the structure of production adjusted*'. The source however could not be said to be purely monetary but rather a combination of relatively cheap money by historical standards and Keynes's

animal spirits of investors.

Hayek's analysis of these issues provoked harsh criticism by Piero Sraffa. Sraffa's review in March 1932 and his rejoinder to Hayek's reply in June are even more notable since Sraffa was a distinguished economist but these works were his sole publication in 25 years.

Zappia (1999), identifies three main points in Sraffa's review:

- The role of money in the economic system: Hayek omits the medium of exchange function of money such that the distributional effects of a rise in the general price level (between debtors and creditors for instance) play no role.

- Forced Savings: Sraffa disagreed with Hayek's notion of Capital consumption, using the analogy of a robbery where '*one class.. has robbed .and ... saved the plunder. When the robbery comes to an end it is clear that the victims cannot possibly consume the capital which is now well out of their reach*' (Sraffa, 1932a: 203-204).

- Sraffa sees Hayek's fundamental mistake as the belief that '*the divergence of rates is characteristic of a monetary economy*'. Sraffa sees equilibrium when the market rate equals the natural rate. In such a case the spot and forward rate coincide. Sraffa argues that there would be as many natural rates as there were commodities so that divergence between rates was inevitable and '*essential to the effecting of a transition as is the divergence of prices from costs of production; it is in fact another aspect of the same thing*' (Sraffa, 1932: 206). It was in his reply to this last point that Lachmann (1986: 237) labelled as the '*fatal concession to his opponent*'. Hayek implicitly admits that the multiplicity of interest rates is incompatible with his framework although he maintains that it is possible to have a number of divergent interest rates, all of which are in equilibrium.

Sraffa's critique of *Prices and Production* did irreparable damage to Hayek's reputation. Hayek was unable to defend himself against the two greatest flaws in his reasoning: his omission of the multiple functions of money and his inability to incorporate a multiplicity of interest rates into his theory.

Frank Knight in a letter to Oskar Morganstern said '*I wish he (Hayek) or someone would try to tell me in a plain grammatical sentence what the controversy between Sraffa and Hayek is about . I haven't been able to find anybody who has the faintest idea*' (Kurz, unpublished: 1). Kurz referred to it as '*far from being two sides of a debate, (they) passed each other without touching*'. From this it is clear that the discussion of relatively obscure topics such as the neutrality of money or theories of savings and investment, while the Great Depression ravaged economies in the real world, baffled contemporary economists. It certainly did not help that Hayek had introduced terminology such as the "roundaboutness" of the production process, "capitalistic methods", "the coefficient of money transactions" among others to explain his ideas.

Sraffa's criticism has been seen as '*an attempt to divert the interest of economic profession towards a macroeconomic approach in the face of mainstream inability of explaining permanent unemployment. To undermine the soundness of Hayek's theory of real economy was Sraffa's main goal on behalf of Keynes*' (Zappia 1999: 1). Sraffa's denunciation of Hayek dealt a fatal blow to both the Austrian school and its most high profile proponent. Hayek retreated from the forefront of economic debate just as the Keynesian revolution revved up a gear.

The disagreements did not follow the implicit rules of academic discourse of the time and at times became quite antagonistic. Keynes moved on to greater things leading the Keynesian revolution. The debate has been referred to as a duel, battle or war. Lachmann (1986: 226) said '*Sraffa's review was an onslaught conducted with unusual ferocity, somewhat out of keeping with the tone ordinarily adopted by reviewers in the Economic Journal*'. This gives an accurate impression of the hostility of some of the arguments as well as implying that there was a clear winner and loser. Keynes won while Austrian economics was discarded despite containing many elements that could have enhanced economic theory.

In the 1930's the unity of economic thought was taken as given where the *Methodenstreit* was considered a thing of the past. The complete defeat of Hayek restored that unity for several decades. There are advantages to constructive discourse among heterogeneous economic thought as is the case today where Post-Keynesian, New Classical Macroeconomis (Mark I and II), and many others vie for attention with

their interpretations of the business cycle. Many of these diverse writers count Hayek among their intellectual forebears. Unfortunately the Keynes-Hayek-Sraffa debate was rather more destructive of each other's theories than constructive. The real loss is to the evolution of economic theory as a whole.

Denationalisation of Money

The conferment of the Nobel Prize for economics in 1974, in a sense, brought Hayek back from the wilderness of economic theorising. In the decades following his defeat in the 1930's debate he had turned his attention to political and legal philosophy and epistemology. In 1976, he wrote *Choice in Currency: A way to Stop Inflation* followed by *Denationalisation of Money* in 1978. It is the latter of these two works which best expresses his proposal to reintroduce discipline in the form of competing currencies. Hayek's proposal comes complete with a practical programme for its implementation. The work represents the final stage in the evolution of Hayek's monetary thought. It incorporates many of his monetary ideas developed in the 1930's, remaining faithful to his doctrine of the importance of relative prices and the uselessness of the aggregate concept of the general price level. In many ways however, it departs from some earlier recommendations, in particular he no longer sees the gold standard as the most favourable means of ensuring price stability. His philosophical stance is evident throughout. He uses the concepts that he developed in *The Road to Serfdom* (1944), *Individualism and Economic Order* (1948) and *The Constitution of Liberty* (1960). These concepts include the perception of competition as a discovery process, the role of price signals in overcoming information problems and the inability of a central government authority to process all relevant information. They are employed to promote the central proposition; that the market process is the most effective means of ensuring price stability. *Denationalisation of Money* begins with a brief history of the evolution of the idea of currency competition and its historical precedents. Currency competition as advocated by Hayek should be distinguished from the notion of "Free Banking", which refers to a monetary system without a central bank, where private banks issued their own notes in a common and fixed unit. Its practice in the 19th century involved a guarantee of convertibility into gold and silver.

He pointed out that practically all governments in history have used their exclusive power to issue money to '*exploit and defraud*' the people (Hayek, 1978: 33).

Government monopoly of coins in a metallic system was initially needed to establish and certify uniform weights and measures. Subsequently seignorage became an important source of revenue and so Governments enforced the view that national currency was essential to national sovereignty.

Hayek inverts Gresham's law that there is a tendency for bad money to drive out good, making a government monopoly necessary. He contends that Gresham's law only holds if a '*fixed rate of exchange between the different forms of money is enforced*' (Hayek, 1978: 43). Issing (1999), applies Hayek's theory, that good money drives out bad when there are floating exchange rates, to the context of different national currencies. There is some empirical evidence that the Deutchmark and Dollar have replaced depreciating national currencies. However, Issing remarks that Hayek neglected the effect of contagion which has also some empirical backing in recent history of international finance, where there is '*contagious spill-over despite healthy economic fundamentals*' (Issing, 1999: 21). It is possible that in the extreme case of a severe loss of confidence in one currency, the public could withdraw from the monetary system altogether and revert to another form of exchange such as barter, which is hardly conducive to the smooth functioning of the economy.

Hayek proceeds to propose his practical programme taking the example of a Swiss joint-stock bank issuing private currency which is tied to a commodity equivalent, whereby the bank guarantees a constant purchasing power in terms of those commodities. Hayek justifies his choice of raw materials prices as the base to which the currency is tied since they act as a proxy for prices of the factors of production; land and labour, which cannot be measured accurately. Hayek sees the value of money as constant but not fixed, varying against other currencies. The issuing institutions would have a strong incentive to keep the value of their currency stable in terms of purchasing power since any depreciation of the currency will lead people to stop holding it and the banks will go out of business. Central banks have no such incentives. The banks will keep the value constant by controlling its quantity. Competition between banks will not degenerate into excessively cheap money since any expectation of a depreciation from excessive lending will mean the bank will go out of business. Hayek sees the role of the press in communicating any price divergence to the public as essential. He gives a prominent role to computers and new technology in overcoming the logistical problems of many currencies. Issing (1999) addresses the role of digital money and in this respect it may

seem that Hayek was remarkably prescient about the role that new technology would play in transforming the working of the financial markets.

In *The Denationalisation of Money* Hayek suffered from the same misconception with regards to the function of money that Sraffa identified with *Prices and Production.* He sees the basic function of money as a medium of exchange. While he now admits that the store of value and unit of account functions exist he sees them not as functions but as '*consequences of the basic function of money as a medium of exchange*' (Hayek, 1978: 67). He recognises the importance of stability for money as a unit of account but does not dwell for long on the subject. Issing however, stresses the importance of money as a unit of account. If there are as many "numéraires" as issuing banks, which is feasible in Hayek's system, then this will damage financial communication, confusing price signals. Strangely enough, Hayek is not an advocate of floating exchange regimes since to him they are too concerned with the relation between general price levels of different countries and distort relative price movements, since a change in one price invokes a reaction via the exchange rate on all prices. He continues in his opposition to aggregation maintaining '*the uselessness of the Quantity Theory for our purposes*' (Hayek, 1978: 76), preferring the cash balance approach of Walras, Menger and Marshall. Hayek agrees with monetarists on the importance of money in the economic system and that there is no such thing as cost-push inflation. Nonetheless, he disagrees on the Quantity Theory, the efficacy of monetary policy and on the benefits of indexation. He sees the latter as a partial remedy '*weakening the resistance against inflation*' (Hayek, 1978: 82) and prolonging and increasing it.

He is all the time critical of the Keynesian hangover after three decades of government intervention leading to a situation where he sees the government portion of output of 60% in countries like Sweden and Britain as eventually reaching 100%; effectively a totalitarian state.

The effect of currency competition, as advocated by Hayek, resolves his earlier problem in the 1930's of the inequality of Savings and Investment, where stable prices will equate the two. He also returns to the "fictitious" concept of neutral money. To this however he has "no ready answer" (Hayek, 1978: 88).

Hayek goes into detail on how the opposition to his proposal and other practical issues

are to be overcome. He even stipulates the exact method of transition. However the reader must find difficulty in accepting that the process would be anything but smooth and painless. One is reminded of the argument against disinflation, where ideally one would prefer to start from a position of zero inflation but the disadvantages of disrupting the established economic order, with lasting effects on growth, would not outweigh the benefits of zero inflation.

With regards to monetary policy it may seem evident now that Hayek reserved no place for it in his system. '*It simply could not exist*' (Hayek, 1978: 100) and that its termination was the deserved result of the Central Bank having '*discredited itself*'. He argues that a single monopolistic governmental agency can't possess the information needed to set monetary policy appropriately, nor is it capable of acting in the general interest or even knowing what the general interest is, since there are no price signals to summarise the relevant information. Central Banks would be abolished along with national, territorially determined currencies, while balance of payments problems would cease to exist. In Hayek's system there would be no fixing of interest rates, which he regards as another trick of government to get cheap money. Governments would then be forced to balance their budgets. Hayek notes that '*nothing can be more urgent than to dissolve the unholy marriage between fiscal and monetary policy*' (Hayek, 1978: 117).

Issing (1999), identifies the key problem of Hayek's proposal, as arising from his conceptualisation of the market as a discovery process. Hayek has complete faith in the market in contrast to his extreme distrust of the government. He does not admit that government can have any useful role in overcoming market imperfections or incomplete markets. The network externalities identified by Issing include the possibility that an inflationary bank may not be dislodged. He also notes the assumption of '*complete, symmetric and free information*' is unrealistic in banking activities where credit rationing is a rational consequence of asymmetric information. (Stiglitz and Weiss, 1981: 393-410). Hayek believes that the chief task of an '*economic theorist or political philosopher should be to operate on public opinion to make politically possible what today may be politically impossible*' (Hayek, 1978: 17). There is a distinct ring of the "constructivist rationalist" approach to this task. Ironically, it was this approach to economics that Hayek was so critical of in Keynes's policy prescriptions. Throughout his life Hayek criticised those who attempted to build a utopia. Most frequently Keynesianism and Totalitarianism received the brunt of his criticism. However in

Denationalisation of Money his primary criticism of EMU was that it was utopian compared to his more practical proposal (Hayek, 1978: 23). Recent events attest to the

fact that quite the opposite is the case.

Hayek was firmly opposed to the European Monetary Union. He '*strongly sympathise(d) with the desire to complete the economic unification of Europe*' but could not give his assent to the entrenchment of the institution of the Central Bank which he was arguing to do away with. Thus it is appropriate that we address the criticisms of one of the leading proponents of EMU, Otmar Issing of the ECB, who is also instrumental in the execution of the transition to the Euro. Hayek saw Monetary Union, with the creation of a single currency as '*more deeply entrenching the source and root of all monetary evil*' (Hayek, 1978: 23). Issing argues that the ultimate aim of EMU is identical to Hayek's: the denationalisation of money. He also contends that EMU has gone some way, since the publication of Hayek's paper in 1976, in realising increased competition in inside money among private banks within Europe, which has been hastened by the technological progress in settlement and transactions.

Conclusion

'*Should Prices be allowed to fall in response to real economic growth, or should the money supply be expanded to "accommodate" the increases in real output? This is a question that separates Austrians from Monetarists in modern debate. It is also a question, some have claimed, which separates the early Hayek from the later Hayek...but the evidence ... supports a different view...Hayek of the 1980's is pretty much the same as Hayek of the 1930's*' (Garrison, 1984:313).

There was a "drift" rather than "shift" in the focus of Hayek's writings between the 1930's and 1970's. In the early years his focus was on the operation of the market process if consumers' preferences were to be transformed into producers' production plans and how government or bank policy could interfere with the process. Later he focused more on how this market process could operate considering the incomplete and dispersed information on which the process is based on (Garrison, 1984). He had integrated his philosophy, developed in the intervening decades, to enhance the intellectual underpinnings of his economic theory in a way a pure economist could not.

The motivation behind *Denationalisation of Money* was simply to eliminate inflation, which was responsible for the severe bouts of unemployment and recession experienced in the developed world in the twentieth century. In a biography of Hayek, Shackle (1981), identified the three great concerns of his life as an academic: monetary prolifigacy, individual freedom, and the nature of knowledge. He did not pursue these strains independently but wove them into the fabric of his writings, consistent with his approach to dealing with problems of economics, philosophy and politics as a praxeology.

Although his theory may not have changed dramatically in essence between the two periods under discussion, his approach to policy recommendation underwent a metamorphosis. The lack of any firm, practical policy prescription in *Prices and Production* to overcome the Great Depression (besides to do nothing), in stark contrast to Keynes's alternative, was a hindrance to the acceptance of his theory to a more general audience. This was compounded by the complexity of the exposition of his theory. *Denationalisation of Money,* on the other hand, gave clear instructions, in simple language aimed at the layman, as to how to overcome the inflation plaguing the Developed World at the time of its publication. That it was not implemented is probably it being perceived as too radical, but let us not forget that Keynes's theories were also seen as radical at the time. The difference is that there was no less radical alternative to Keynesianism, since Austrian economics had been so successfully eradicated, whereas in the 1970's there was, namely monetarism.

Hayek's contribution to monetary thought has not been incorporated into the mainstream. His works serve as a basis for raising and perhaps even resolving many issues in the future, but his real contribution is that he stood as alternative to the orthodoxy, a different way of seeing the economic world.

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