MONETARY THEORY AND THE WORKING OF THE MONETARY SYSTEM IN THE WEST

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Mr. Vice-Chancellor, Mr. Dean of the Faculty of Economics and Administration, Deans of other Faculties, Members of Senate, other members of the scientific Staff, Students, and all of your honouring me with your presence here to-day, Ladies and Gentlemen -

INTRODUCTION

The paper I am presenting to you to-day is the outcome of an international monetary conference on "Government Policies and the Working of Financial Systems in Industrialized Countries" I attended in Madrid last year. Although it is of course not a summary of the proceedings of that conference, it is fair to say, however, that my lecture is the result of a study that was inspired by it.

A second preliminary remark I would like to make is that the present subject may seem like an esoteric argument among economists and politicians, but it is actually very much a part of people's lives. Indeed, the government's role in economic life is affecting everybody's material well-being in one way or another.

We know from experience that by exchange, goods and services become more suited to the satisfaction of wants than before. Exchange transactions, therefore, create new and additional gains over and above the values that existed before. This also means that the original meaning of the concept of value has been maintained, viz. value is not a property of the good itself, but depends on subjective value judgements. However, the result of exchange is the emergence in society of a network of value relationships which has an independent existence. These value relationships find their expression in terms of money, which are the prices at which goods and services are exchanged.

Money is an integrated part of our society; it is a many-sided human creation with kaleidoscopically contrasting aspects. Like value, money has something personal about it; it has a place in the individual's discreet sphere of life. Don't we regard the contents of our purse and the state of our bank account as a private matter which is no business of others?

At the same time, however, money is pre-eminently a social phenomenon in that it is essential in exchange, price formation and the division of labour. Our society could not function without a highly developed monetary system.

There is one other observable fact about money. Our need of goods and services becomes particularly apparent when we are short of money, whereas the possession of it provides wealth and power. Because of this the

use and possession of money are charged with emotional feelings. It sometimes makes people stray from the straight and narrow path of honesty. "Money", according to Robert Owen, "is the root of all evil" (Frankel, 1977, p 2).

The emotional aspect of money has its counterpart, however. A money price is what must be sacrificed in production and exchange. Consequently, money is used in rational calculation. In other words, money serves the cause of efficiency and suitability, but it can also be used for blackmail and exploitation.

Finally, money is a relative matter in that it gives an indication of value relationships within a particular society. For this reason the monetary system is an integrated part of our culture. Indeed, money is the expression of the relativity of all things.

It is clear, therefore, that a fundamental distinction exists between the monetary unit as an independent, strictly logical phenomenon, and as a many-sided human creation (cf. Simmel, 1907). Monetary theory should have made a choice in this regard but thus far has not done so. The problem seems to be that in our Western Society money functions as a many-sided human creation as opposed to the theoretical view on money as an independent, strictly logical phenomenon. In succession this has been the case with the Neo-classical, the Keynesian and the Monetarist views on money.

All three monetary variants have a particular view on how to shape the economic process along strictly rational lines. In this process money plays a specific role as a unit of account, a medium of exchange, a store of wealth and a standard of deferred payment. Thus, in this view, money plays an independent role, detached from human emotions. From the view as to how the economic process is to be shaped and the ideas regarding the manner in which money fulfills its functions follows a particular concrete task for the monetary authorities. The execution of this task comprises the application of policy instruments to realize certain objectives. What are these objectives and what are the instruments of monetary policy at the disposal of the monetary authorities?

All three versions in the development of monetary theory have the common characteristic that as time went by the objectives of monetary policy and the application of policy instruments have become less and less acceptable, since each of the theoretical variants have caused tensions in our society that have led to radical changes.

Each of the three versions gives a characteristic answer to three questions:

(1) Who is best capable of shaping the economic process? In other words, where does the economic intellect reside?

(2) What role does money play in economic life?, and

(3) What is the importance of monetary policy?

As to the first question, the Neo-classical view is that the economic intellect resides in the individual who aims at the maximization of his satisfaction and, in business, the maximization of his profit. Hence in a free, liberal society there is a tendency towards economic equillibrium characterized by the maximization of utility and income, the equality of savings and investments and full employment. Whether or not this equilibrium is attained depends on price and income relationships in which money does not play a decisive role; money merely facilitates exchange. This also answers the second question concerning the role money plays in the economic process.

From the process of exchange certain goods emerged which could best perform the function of medium of exchange, viz. precious metals, so that in Neo-classical liberal society the Gold Standard came to be the basis of a strict individual evaluation of the monetary unit.

As regards monetary policy under the Gold Standard — the third question —, its norms were derived from the technical arrangements of the monetary system. Its goal was that the system should operate according to inherently rational rules, which meant in reality that it was only necessary to maintain a certain gold cover in proportion to banknotes issued, as prescribed by law.

Monetary policy, therefore, implied the strict application of the rules of the Gold Standard game. This line of policy can only succeed if the gold price and the percentage gold cover give rise to an acceptable price level and if prices and incomes are flexible. When after WWI the Gold Standard was restored in 1925 on the basis of the pre-war gold price, these conditions were no longer met. The restouration of the Gold Standard on the basis of the pre-war gold price put too much strain on the price levels while the required price and income flexibility in fact no longer existed. Thus, the Gold Standard could no longer be maintained in the 1930's. Since then a monetary policy on the basis of Neo-classical theory belongs to the past. On close inspection this represents the failure of monetary policy under the Gold Standard in that the monetary policy objectives derived from the Gold Standard were no longer acceptable nor were the corresponding "rules of the game". The true nature of the mechanistic-analytical approach had been revealed and necessitated a thorough reconsideration of the monetary system at the time. J M Keynes was the severest critic of the prevalent monetary system. (Frankel, 1977, pp 57-85).

Keynesian monetary theory

Keynes argued that "all civilized money is chartalized and is a creation of the State". Here we notice a dichotomy in Keynes of which the significance has been almost completely overlooked (Frankel, 1977, p 57). In his study

"Indian Currency and Finance" (1913), Keynes, on the one hand regarded "gold in circulation as essentially wasteful" and stated that "India should be encouraged in all reasonable ways to develop economical habits in matters of currency". For the State, which creates money, is not required to bring gold coins into circulation. Here Keynes regards the monetary unit as an independent, strictly logical phenomenon, created by the State. On the other hand, however, he deemed it desirable that the Indian Government "should continue to act on the principle of giving her citizens the form of currency for which they ask". This points to the monetary unit as a many-sided human creation, since the Indian people had a strong preference for gold coins. They could hoard them, because "the precious metals were the only real money they could trust" (Frankel, p 58). The dichotomy is clear: Keynes opted for the monetary unit as an independent, strictly logical phenomenon, although he did not want to abruptly change India's monetary order in accordance with his ideas, but he considered the hoarding of gold as "barren"[1]).

Consequently, Keynes came into conflict with individual freedom. In India, the hoarding of money served as "a bulwark against the encroachment by government or by rulers on individual freedom and as such it offered a protection of their small savings against future uncertainties" (Frankel, p 59). To a large extent freedom and uncertainty coincide. If the future were perfectly predictable all uncertainty would disappear, but so would freedom. This was certainly not what Keynes intended. Nevertheless, he was critical about the spending power individuals had and the freedom of choice they could exercise between consumption, saving and investment.

Keynes's critisms formed the central part of serious doubts about the then prevailing economic system. According to Keynes the greater part of the citizenry had been leading an examplary life during the industrial climb of the West; they had worked hard although their standard of living was low. But political behaviour, militarism, imperialism, rivalries among races and cultures, monopolies and restrictions played the roles of "the serpent to this paradise". The socio-economic order of the West was, according to Keynes, characterized by deceit and bluff. The deceit was clear from the way the labouring classes were exploited. During the industrialisation of the West this class played its role on the basis of ignorance and powerlesness. The proletarians had to work hard for a meagre wage. The importance of investment activity was characterized by bluff. Although impressive capital installations were constructed they seldom led to the improvement of the lot of the masses.

The changes that took place after 1914 represented a "discovery of the bluff" (Frankel, p 68), since the labouring class no longer accepted its inferior position in society and the capitalist class was no longer confident of the future. It was not the discovery of the bluff, however, but political

defeat that brought economic and monetary disorder.

In the 19th century capitalists had believed in themselves and their value to society. They thought it proper to continue in the full enjoyment of their riches and power. But now they allowed themselves to be ruined and undone by the governments of their own making and the Press which they owned. Thus, Keynes made it appear as if the monetary order was a class order: the owners of capital, as investors, were to be regarded as responsible for their own destruction. In a capitalist society investment calculations are by nature not in tune with the general wellbeing. Without accepting an Eastern European type of Command Economy, Keynes foresaw "an ever greater responsibility for directly organising investments by the State" (Frankel, p 72). Consequently, the monetary system also had to be changed. Unlike certain utopian monetary reformers, Keynes did not want to abolish money, because "he was far too intelligent to believe that money could be got rid of so easily" (Frankel, p 75). On the contrary, Keynes was primarily concerned with the theory of a monetary economy. But this did not prevent him from advocating fundamental changes in the monetary order so as to transform money into an independent, strictly logical phenomenon. With this in mind he pleaded for a monetary order on the bassis of "public wisdom" (Frankel, p 76) and suggested two far-reaching changes.

Firstly, he wanted to abolish from the monetary system the individual's freedom to act according to his own wisdom in money matters. By abolishing the individual's "money motive" Keynes in fact went as far as to reject the objectives which individuals wish to achieve through the spending of their money (Frankel, p 79). In this way the monetary unit becomes an entirely independent phenomenon.

Secondly, instead of individuals taking the decisions he advocated a considerable increase in State responsibility to organize investment, because the State would be in a position to calculate the marginal efficiency of capital on long views and on the basis of the general social advantage (Frankel, p 79). Thus, to overcome the alleged inefficiency and ignorance of individuals, he advocated that the government determine policies concerning investment programmes.

Keynes had a fundamental distrust of the individual's freedom of choice. The cure, Keynes argued in his essay "The End of Laissez-faire" (1926), "lay outside the operations of individuals in whose interest it might even be to aggravate the disease" (Frankel, p 62).

What is the disease? It was the freedom of individual choice in the face of uncertainty. He believed that the cure for these things was "to be sought in the deliberate control of the currency and of credit by a central institution and partly in the collection and dissemination of data relating to the

business situation, including the full publicity of all business facts which it is useful to know" (Frankel, p 62). "These measures would involve society in exercising directive intelligence through some appropriate organ of action over many of the inner intricacies of private business ..." (Frankel, p 62). These passages throw light not only on Keynes's attitude towards uncertainty, but also on his despair concerning what he regarded as "the lack of knowledge and its total dominance of human affairs". Money, according to Keynes, is to serve as a unit of account, a medium of exchange and a store of wealth in a centrally guided economy and monetary policy should fit into this arrangement.

Keynes's distrust of the role money played in a liberal society is retained in a more moderate from in his famous book "The General Theory of Employment, Interest and Money" (1936). According to this theory money is held on the basis of rational motives regarding its liquidity: the transactions, precautionary and speculation motives. This line of thought is in accordance with Neo-classical doctrine, however with two far-reaching amendments.

Firstly, although economic equilibrium — after the multiplier has worked out its full effect — may bring equality between saving and investment, this is no guarantee that full employment is attained. According to Keynesian theory monetary policy is hardly of any significance for the attainment of "full employment equilibrium".

The second amendment of Neo-classical doctrine implies that emphasis is placed on the relatively great importance of the speculation motive. During the Depression of the 1930's and the difficult period of reconstruction after WW II the idea took hold that sombre profit expectations, a low rate of interest and structural stagnation would form impediments to private investment. Newly created money would disappear immediately in speculation cashes. Under these conditions monetary policy would not be able to contribute to economic revival. Therefore, preference was given to the government's so-called "fiscal policy".

Present-day problems

After WW II the West saw the rise of the mixed economy, comprising a private sector, a collective (or public) sector and a fiduciary monetary system. However, an economic system which is the product of a cricital ideology, as in the West, is liable to change from time to time. The traditional defence of the liberal economic order by economic science lost its meaning. The transformation to a mixed economic order was sympathetically received, particularly so in socialist and christian circles. This system has now been in operation for nearly forty years and new problems have arisen which again call for a reorientation of the economic order, including the monetary order.

An important source of concern is the excessive growth of the share of the public sector in total GNP over the last two decades. From 1960 to 1980 this share increased from 29 to 42% of GNP on average for the OECD. In Holland this increase was from 34,2 to 54,6% of GNP and in Spain and Sweden the government's share ranged from 30% to over 60% respectively in 1980. If this trend is not called to a halt the entire national income will find a collective allocation in the not too distant future! This is unlikely to happen, however, for it is obvious that too large a transfer of income will reduce economic activity to nil. What is necessary is a reversal of the trendlike increase in the relative collective burden. The question is how this can be brought about. This will be a central problem of many Western mixed economies in the last quarter of this century. For the time being it can only be noted that a reversal of this trend is urgently required because stagnation is spreading in the West.

In the world of business profitability has been declining. The internal financing of firms has drastically decreased and capital ratios have deteriorated. Many companies are no longer able to carry the burden and have called on the government for assistance. Consequently, governments often find themselves in a most peculiar situation in that they badly need the income from taxes and social security premiums from the business sector in order to finance their ambitious social security programmes. On the other hand, governments are called upon to come to the rescue of companies that are in trouble mainly as a result of having to bear the collective burden. This kind of policy is like fighting the symptoms of a disease which is caused, at least partly, by governments themselves. What happens next is the emergence of a confused attitude toward money.

The minting of money by governments — for the first time in Lybia and several small Greek states, presumably in about 700 BC — was a big improvement at the time. However, many instances have been recorded in monetary history of governments that have undermined the monetary order. Right now the West is experiencing this peculiar situation in a contemporary variation. There is no doubt in principle that in to-day's mixed economy the government, notably the Central Bank, is mainly responsible for the maintenance of a stable value of money. Neither can there be any doubt about the tremendous rise in public expenditure that has been taking place after World War II in particular. Consequently, governments have called upon their Central Banks for large amounts of funds for structural purposes, usually to finance the Welfare State. This points to a possible undesirable development as far as the relationship between the State and money is concerned. For what in fact has happened is that Central Banks have often been instrumental in financing the governments' deficits and public debts. Table 1 shows how government deficits of several Western countries have increased over the years.

TABLE 1 GOVERNMENT DEFICITS AS % OF NOMINAL GNP/GDP

	1971	1980	1982	1984+)
Japan	-1,4	6,0	5,5	
Germany	0,1	3,9	4,4	
France	-0,7	-0,3	2,7	
Italy	7,1	8,4	11,9	
Netherlands	0,5	5,9	8,4	11
USA	1,7	1,2	3,8	5

Source :J.P. Chouraqui (OEDC, Paris), *Budget Deficits, Monetary Growth and Financial Crowding out*, Paper to SUERF-Colloquium, Madrid, October 1983, p 18.

Minus sign denotes a surplus.

+) Expected

But this is not all. Over the 1970-'79 period inflation in Western countries still averaged 9% (Korteweg, 1984, p 5). Real interest was low, in fact, nearly zero. The depreciation of money preceded the rise in the real rate of interest. In 1982, for example, it averaged 4,5% in Western countries. This change was brought about under the influence of large government deficits, particularly in the USA. The present US budget deficit, which absorbs more than 70% of that country's net capital formation is likely to remain high far into the expected recovery, meaning that it is to a large extent "structural" (Emminger, 1984, p 8). This is bound to have a strong impact on interest rates and a "crowding-out" effect on private investment. However, this is less so in the US than in other Western countries.

In the US the crowding-out of private investment is mitigated by the inflow of foreign capital, attracted by the same high US interest rates; the long term nominal interest rate was 12,9% in the US in 1982 (Emminger, p 8). In this way the private sector was to a large extent crowded out of the capital

market and interest rates increased sharply. The result is that the business sector is subjected to a heavy collective burden in addition to the high interest rate. This is not all, however, for the business community's problems are passed on to the banking sector in the form of bad credit risks. And, as Otmas Emminger (a former President of the German Bundesbank) stated: "We see that in those European countries where budget deficits are very high in relation to net national savings, Central Banks are often under pressure to finance at least part of the deficits by money creation. Thus, it is still true that high public deficits can easily become a source of inflation" (Emminger, p 9). This could mean that the prospect of a continuous decline in the value of money, for which governments are to a large degree responsible, lies ahead of us.

As noted above the problems of the business world are being shifted onto the banking sector in the form of bad credit risks, and this of course could lead to serious banking problems. Dr Pieter Korteweg (Treasurer-General of the Ministry of Finance of the Netherlands) said in this respect: "All over the world the solvency of banks is in danger because of the poor economic situation in Western countries which has forced many banks to write off loans to firms which cannot meet their obligations. In addition, banks are afraid they will incur losses on loans to developing countries" (Korteweg, p 6). Consequently, relations between government policy and the monetary systems may become strained via the business and banking sectors.

This raises the question as to the proper functioning of to-day's monetary unit as a stable standard of value in the near future. A stable standard of value only exists if the price of money, the interest rate, does not contain a disturbing inflation component. The rate of interest, as the price of money, expressed in terms of money, does not refer to any particular goods, but is an indication of the way the monetary unit fulfils its functions as a unit of account, a medium of exchange and a store of wealth. However, if it does contain an inflation component this points to a deterioration of the functioning of money. Consequently, money can only function properly as a stable standard of value if the real rate of interest is known. In the future money can probably play this role only imperfectly, if not poorly, due to the ambivalent attitude of governments to money. This attitude is inherently contradictory, for, on the one hand governments regard the maintenance of monetary stability as one of their goals, but, on the other hand, they consciously disregard the means necessary to do just that. It is inherently contradictory to make a promise whilst at the same time creating a situation in which it is impossible to fulfil that promise. Yet, this is exactly what has been happening in recent times. It is high time, therefore, that Western governments put their money affairs in order.

The Monetarist perspective

Of central importance nowadays is the question whether or not monetary

policy is positioned to relieve the situation. This should be viewed in the light of the following remark made by Otmar Emminger (p 4):

"Keynesian demand management has been pushed into the background not only because of its potential inflationary implications and its conflict with anti-inflationary monetary policy, but also because it was incompatable with the imperative medium-term task of cutting down intolerable structural budget deficits".

A recent reconsideration of the role of money in the economic process has been undertaken by the Monetarist School, of which Milton Friedman of the University of Chicago is the best renowned exponent. The monetarists argue that post-war Keynesianism has led to excessively erratic management of the economy. They say that the instability of the economic process has monetary causes. Disturbances result mainly from sudden changes in the stock of money. It is the monetary authorities' responsibility to prevent this. They should increase the stock of money gradually over time, because nothing is worse for the stability of the economic process than a stop and go policy in respect of the money supply.

Monetarists claim that, if the increase in productive capacity is only about, say 3% a year, any rise in money supply above this will lead to inflation. At its simplest, the monetarist view is based on an observed close connection between the rise in the money supply in one year and the rate of price inflation a year or 18 months later. If, however, the money supply is kept under control, employers will either be unable to pay higher wages or, if they do, some will go out of business and unemployment will rise. This does not mean that monetarists must favour high unemployment. But monetarists are sceptical of the governments' ability, other than over a very short period of time, to push the rate of unemployment below its "natural" level as dictated by structural and institutional factors.

The government can, for a time, push unemployment down or employment up by running a public deficit. But when it does so, it makes the rate of inflation harder to control later on. The deficit leads to an excessive expansion in the money supply allowing the rate of inflation to accelerate. Wage demands are thenceforth pitched at a higher level to allow for what comes to be regarded as the going rate of inflation.

As it is assumed that economic agents act rationally, they will make full use of all the available information and not just rely on past values of relevant variables. According to this view even a short-run trade off between inflation and unemployment is not possible, as was suggested by the theory of the Phillips curve (Levačić and Rebmann, 1982, p 340). Rational expectations will render the Phillips curve vertical so that the unemployment situation can no longer be affected by monetary policy (Levačić and Rebmann, p 344).

The change in expectations is built into the system so that, when the brakes are put on again, the rate of inflation remains permanently higher relative to the level of employment than before. The longer the government goes on feeding cost inflation in an effort to secure full-employment, the higher will be the ultimate level of unemployment needed to cure inflation. Robin Friedland's (a former senior editor of the *Financial Mail*) opinion is significant:

"So, when the politicians — and at one removed — the central bankers are presented with a stark choice between renewed inflation and monetary and banking collapse, there cannot really be much doubt that they will choose inflation. Anything is preferable to a replay of the Thirties at a time when the masses have lost whatever docility characterized them then". (Friedland, 1984, p 41).

The meaning is clear. Similar to the Neo-classical view, monetarists claim that money, notably monetary policy, cannot be effectively applied in the pursuit of economic stability. Money, therefore, retains its neutral character in regard to the economic process. Thus, the monetarist theory, strengthened by the theory of rational expectations leads one to conclude that it is wiser to heed the monetarist advise about monetary policy, viz. to allow the stock of money to grow in proportion to the real growth of the national income.

The question remains, however, whether the monetarist policy advice is directed to attainable monetary policy goals. This question should be viewed in the light of the dangers presently threatening the monetary system of the West.

Monetarists do not regard money as a many-sided human creation. Rather, to them the monetary unit is an independent efficiency factor in the hands of the economic agents operating in the market economy. In order to avoid disturbances in the economic process the supply of money is subjected to a stringent condition. The question arises as to who is responsible for meeting that condition? It is clear that the monetary authorities are to be held responsible for the application of the money growth rule. Thus, the Central Bank is instructed to mark out the path along which the future supply of money is allowed to grow and subsequently announce and execute it.

In our society, however, money is not an independent efficiency factor employed by the *homo economicus*, but a many-sided human creation. This implies that the monetary authorities have only a limited influence on the functioning of the monetary unit. This is the reason why monetarist policy advice exaggerates the effectiveness of a monetary policy according to the money growth rule. Monetarist policy will have three negative results:

(1) The monetarist view is unrealistic in its belief that in Western society the Central Bank is able to control the liquidity creation as it is supposed to do. In our society freedom also implies that the monetary authorities cannot regulate the creation of liquidity directly on the basis of a prescription for the use of money. The most they can do is exercise control indirectly through entries in the Bank's balance sheet, which forms no part of the stock of money.

If, in spite of this, the realization of the money growth rule is pursued, too great a responsibility is loaded on the Central Bank pertaining to the maintenance of a stable value of money. This the Central Bank is unable to bear, whilst others are possibly unjustly exempted from bearing any responsibility at all.

(2) However one looks at it, the money growth rule will always lead to a rising rate of interest. In the pursuit of economic stability and a stable value of money monetarists emphasize the importance of monetary policy. In that case the rate of interest is likely to rise faster than if a more balanced mix of policy measures were applied. Because governments have been borrowing heavily on capital markets, interest rates are high and a heavy burden on both the business sector and governments (Galli and Masera, 1983, p 7). Since government expenditures have been persistently in excess of revenues financial shortfalls resulted, i.e. government debt burdens rose year after year. These rising government debts have to be serviced, of course, resulting in soaring interest payments to be made. This is illustrated in Table 2.

TABLE 2 INTEREST PAYMENTS BY GOVERNMENTS (in % of GNP ; GDP)

Country	INTEREST PAYMENTS		
	1970	1975	1982
USA	2,2	2,5	4,5
Japan	0,6	1,2	4,3
Germany	1,0	1,4	2,7
France	1,1	1,3	2,1
UK	3,9	4,0	5,3
Italy	1,9	4,0	8,4
Canada	3,8	3,9	7,2
Belgium	3,4	3,5	9,5
Netherlands	3,0	3,0	5,0
Sweden	1,9	2,1	7,1

Source: *P.S. Anderson (BIS, Basle), Public Sector Deficits, Money Supply, Interest Rates and Saving Behaviour*, Paper to SUERF-Colloquium, Madrid, October 1983, p 3.

The application of the money growth rule is likely to increase this burden, thereby endangering the monetary system even more via increasing credit risks of the banking sector and the faltering confidence of both domestic and foreign investors. It would seem, therefore, as far as the problem of the monetary order is concerned, that monetarist theory puts the cart before the horse.

(3) The monetarist view may seem to have some credibility in the short run, but if persistent inflation and high interest rates show that such a belief has no firm foundation, the result might well be another monetary tragedy comparable to the collapse of the Gold Standard in the 1930's. The prevalent high interest rates, the substantial depreciation of money, the stagnant business sector and accompanying problems in the banking sector, once again urge us to take our monetary system into reconsideration. A new solution shall have to be found on the basis of acceptable monetary policy ideals. A first requirement is to put our monetary affairs in order with a view to the efficient functioning of our monetary system in the future.

A reconsideration

The conclusion seems to be justified that monetarism offers little perspective; it does not give the right answers to the pressing problems of our monetary system. Consequently, it is still an open question as to which policy to apply if the monetary unit is to function efficiently as a stable standard of value in the future. The possible shape of such a policy depends, to a large extent, on monetary freedom as it still exists in our society. For an indication of this freedom the distinction pertaining to the nature of money is of fundamental importance. The question is, whether the monetary unit is an independent, strictly logical phenomenon or a manysided human creation.

The former description implies an analytic-ideological approach in the form of a rational monologue. Money fits into this system in such a way that the economic subject is supposed to spend his money in a particular, preconceived way. Conceptually money has been made independent of its user. This is unrealistic, because this line of thought does not account for money as "bloodmoney and bride-money, conscience money and stolen money, easy money, and money that has been earned by the sweat of the brow, money to burn and money as the prize of merit ..." (Wiseman, 1974, p 15). This means that all human emotions which deviate from what has been presupposed about the use of money are set aside. According to

monetarists money should be used in an efficient and cost-conscious way and, next, the monetary system is supposed to operate independently, in a strictly logical manner. In this view only a one-way freedom exists and the monetary authorities have a particular, clear-cut task to perform.

The Neo-classical view was that the monetary unit is nothing more than a piece of precious metal — notably gold — and the monetary authorities only had to apply the rules of the game. According to monetarist theory the monetary authorities' task is simply to apply the money growth rule. This rule is also unrealistic, however, especially in the long run. In reality the Gold Standard ended in a monetary tragedy because the combination of great expectations and the stringent application of monetary policy instruments turned out to be impossible. Monetarism holds the danger of a repetition of this tragedy while it at the same time obstructs a solution to the pressing problems of our monetary system.

In reality money is a many-sided human creation and it is an integrated part of society, i.e. we can shape and give meaning to it ourselves. This implies that monetary theorists are again forced to reconsider monetary matters so as to clearly distinguish between the true nature of money either as a strictly logical phenomenon or as a many-sided human creation.

It concerns a monetary distinction arising from a difference in ideological views on society. The concept of money as a many-sided human creation is based on a historically determined viewpoint on society as it exists. Consequently, the required plans and actions for socio-economic reform will have to relate to place and time also. They do not pretend to hold the eternal truths regarding the socio-economic order for they are historically determined. Consequently, the economic intellect is a relative matter as well and cannot be the exclusive property of either individuals or the State. If it is acceptable that absolute truth is not possible in this regard, considerable room is left for the relative freedom of human actions.

A first requirement would be a declaration of intent by governments as to the desired role of money, viz. as a stable standard of value, so that money can play its stabilizing role again as a unit of account, a medium of exchange and a store of value (or wealth). It is likely that a declaration of that nature will readily be made since no government in its right mind would use money as an instrument to create social inequalities or as a source of disturbances in the economic process. The question is, of course, whether stabilizing the value of money, i.e. maintaining a "reasonable domestic price stability" (SA Reserve Bank, 1972), as laid down in Central Bank Acts, will be sufficient, because *all* public authorities are responsible, since they are relied upon to make decisions that affect the welfare of others.

Furthermore, it should be realized and acknowledged that money in our mixed economy is a many-sided human creation. A direct result of this

requires that monetary theory be no longer caught up in a strictly rational one-sided freedom. In reaity monetary freedom comprises three aspects:

(1) the choice of the monetary unit,

(2) the alternative allocation of money as either a medium of exchange or a store of wealth, and

(3) the possibility of substitution between various forms of liquidity.

Finally, a connection should be made between money as a stable standard of value in our economy and the fact that it is a many-sided human creation. If it is acceptable that money should be a stable standard of value this can only be realized if the threefold freedom mentioned above is left unimpaired. If one considers the concept of monetary freedom and the structure of the monetary system somewhat closer one realizes that other people than the monetary authorities also exert a strong influence on the functioning of money. This may give an indication as to who is responsible for the functioning of money as a stable standard of value in society. The too sharply rising costs of labour, the rising trend in the collective burden, rising government debts, the absorption of capital market funds by governments (i.e. the increasing government borrowing requirements) and the strong pressure on liquidity creation, all ask for attention. The responsibility for these is to be borne by those people or groups of people who are called upon to take the decisions in our society. It is high time that the responsible people start realizing this lest Western society collapses under the weight of labour costs, collective burdens and gaping government budget deficits.

Mr. Vice-Chancellor, I hereby have the honour of accepting the Chair of Economics at the University of the North.

The economist has not only a professional but also a moral commitment to the Society of which he is a member. May I be given the strength to fulfil my responsibilities in this regard.

I therefore pledge to serve the University of the North and its community to the best of my ability.

NOTE:

1) "An order, as distinct from a system, represents the framework and setting in which the system operates. It is a framework of laws, conventions, regulations and mores that establish the setting of the system and the understanding of the environment by the participants in it ... We can think of the monetary system as the *modus operandi* of the monetary order." (Mundell, 1982, p 4).

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