

On Monetarism and Ideology*

I. Introduction

In the course of the current probing of monetarism versus fiscalism, a newly raised subject is the relationship, if any, between monetarism and ideology. Specifically, does monetarism imply or presuppose espousal of a laissez-faire political economy? In turn, have all notable monetarists been laissez-faire proponents? Correspondingly, does any rejection of monetarism imply or presuppose opposition to a laissez-faire political economy? In turn, have all notable nonmonetarists been laissez-faire opponents? In recent writings, such authors as Tobin (1974, pp. 62-3), Mayer (1975, pp. 307-08), and Stein (1976, p. 2) have suggested that the association of right-wing ideology with monetarism is not inherent in the content of monetarism.¹ Tobin, in particular, argues that the widespread attribution of right-wing ideology to the modern quantity theory of money is due to the institutional coincidence of the espousal of both the theory and the ideology in the University of Chicago. Beyond these passing references, however, little supporting evidence and little probing of the monetarism-ideology nexus are to be found in the literature.

The indication of a unique 1930s Chicago monetary tradition by Friedman (1956) provides a useful point of departure for consideration of the conceptual connection between monetarism and ideology.

* We have benefited from helpful comments by Thomas Mayer.

¹ MAYER (1975) does, however, discuss the interrelations between various monetarist propositions and Keynesian economics. Mayer also distinguishes between the quantity theory of money and monetarism in terms of a set of criteria among which the quantity theory is included. Alternatively, monetarism may be viewed as having undergone an evolution in the early phases of which the quantity theory itself was coterminous with monetarism.

Acknowledging Nobay and Johnson's affirmation that "The historical perspective has been a relatively neglected dimension in much of the debate between monetarism and Keynesianism" (1977, p. 471), this essay examines the evolution of the quantity theory at Chicago during the formative 1930s in the context of the ideological articulations of the theory's principal exponents. In turn, the essay also probes into the linkage between opposition to monetarism and the left-right ideological cleavage.

Briefly to anticipate, the coexistence of two strands of monetarism can be identified in Chicago's 1930s monetary tradition. The distinctiveness of these two strands is marked by a variety of features: (a) the interpretation of the causal role of money in initiating cyclical fluctuations, (b) policy prescription for economic stabilization, and (c) the ideological bent of the expositors. It turns out that Friedman's advancement of the quantity theory reflects the dominance of a right-wing version of Chicago's 1930s monetarism over a coexisting left-wing version. Thus, the irony of this dominance, and of the consequent neglect of the left-wing version in the current literature, is that the left-wing version is in important respects more anticipatory of modern Chicago monetary economics than the dominant right-wing version. Hence, it is demonstrated that monetarism is not uniquely assignable to a single ideological bent. Correspondingly, it is also demonstrated that the negation of monetarism, despite the dominance of left-wing ideology among its expositors, does not necessarily presuppose or imply rejection of a laissez-faire political economy.

II. Money, the Business Cycle, and the Chicago Tradition

Though the exegesis of a distinctive Chicago monetary heritage where "money mattered" had been provided by Friedman in his 1956 "Restatement" of the quantity theory, more than a decade was to elapse before the polemics concerning the relevance of that heritage were kindled. Evidently, this was because consideration of the writings and teachings of an earlier generation of Chicago economists increased in importance only as monetarist interpretations began to dominate the macro-economic literature. The increased acceptance of monetarism in the late 1960s and early 1970s induced several of its foremost adherents — notably Friedman (1970 [a]) and Brunner

(1970) — to aver the existence of a monetarist counter-revolution. However, the validation of a counter-revolutionary movement requires the establishment of a "plausible linkage with pre-Keynesian orthodoxy" (Johnson, 1971, p. 10). Yet the claim to such a linkage had already been made in Friedman's "Restatement", and, as a result, the emergence of the neo-quantity theory of money stimulated research into the monetary doctrines of the 1930s Chicago School.

A definitive delineation of the contributions of Chicagoans who wrote on and/or taught monetary economics during the 1930s — in particular Henry Simons, Frank Knight, Lloyd Mints, and Jacob Viner — is due to Patinkin (1969; 1972 [a]; 1972 [b]). Patinkin contrasts the earlier Chicago tradition, characterized by its variable velocity adaptation of the Fisherine equation of exchange, with Friedman's stable portfolio approach to the demand for money. Thus, whereas contemporary monetarists attribute fluctuations in economic activity and the occurrence of inflation to prior movements in the money stock, Friedman's Chicago predecessors were arguing that business cycles were generated by a fluctuating velocity of circulation. The money supply was a passive element in the business-cycle diagnosis developed by the 1930s Chicago School, an element capable of exacerbating, but not of initiating, economic fluctuations.² Evidently, the volume of money was not considered most important.³

There is however, more to the earlier Chicago business-cycle diagnosis than has been conveyed in the recent literature. As noted in the preceding section, there did exist at Chicago a particularly anticipatory adaptation of Fisher's $MV = PT$, distinguishable both by the causal role it assigned to money in initiating economic fluctuations and by its policy orientation. This largely neglected strand of 1930s Chicago monetarism was contributed by Paul Douglas, as will be discussed below. Additionally, further consideration of the Simons-Knight approach reveals that though monetary factors were ascribed a subordinate role in the causal mechanism underlying the cycle, proper control of the money stock was deemed essential in preventing the cycle from occurring. Accordingly, money was ushered-in through the back door and ultimately held center stage.

² A description of this process is provided in FRIEDMAN (1967).

³ Several writers, using Patinkin's work as their source, deny outright the existence of an earlier Chicago quantity-theory tradition. In this context, see JOHNSON (1971; 1972), TEIGEN (1971, p. 244) and MOGGRIDGE and HOWSON (1974, p. 227).

In addition to the primacy accorded to a variant velocity of circulation as the *modus operandi* of its analysis, a striking aspect of the Simons-Knight formulation of business-cycle causation is its unsystematic endeavor to inquire into the factors underlying the variations of velocity. For example, Simons, in an unpublished 1933 monograph, attributed depressions to "some fortuitous disturbance (perhaps a mere speculative scare) which happens to establish a sharp reversal of the trend in product prices" (1933, p. 5). The following year, Simons adduced a declining velocity as due to an overtaking of product prices by factor costs "for any reason" with adverse subsequent implications for business profits (1934, p. 55). Similarly, Knight attributed depressions to such factors as "the overtaking of prices by costs, a crop failure, any calamity in the business world, or mere 'psychology'" (1941, p. 214). Viner argued that a declining velocity was due to a general prevalence of "fear" within the community resulting in sudden reversals of confidence (1932, p. 18). Such attitudes of "fear", according to Viner, were sparked by specific events such as the occurrence of a stock-market crash (1931, pp. 174-75).⁴ Still another Chicagoan, Harry Gideonse, in a neglected 1934 paper on "Money and Finance", argued in terms of "structural difficulties which exhaust the private stimulus to enterprise" (1934, p. 749).

The 1930s Chicagoans perceived a continually fluctuating unit of value as an inherent aspect of economic life. For whatever reasons the variation in the unit of value occurs, they regarded it as leading through rigid costs to corresponding changes in profits and production. Thus,

A standard of value fluctuating erratically in its own value must be an important factor in initiating and in accentuating the recurrent cycles of expansion and depression from which the world has suffered: Jacob Viner (1932, p. 35).

Surely nothing could be more unsettling to an economic system than the fundamental uncertainty of its measure of value: Harry Gideonse (1932, p. 5).

The currency system [is one of] the roots of the immediate difficulty: Frank Knight (1933, p. 422).

⁴ In 1964, VINER argued that the 1930s depression "resulted from epidemic fear, and one of the major fears was that prices would fall still further (given an initial decline)" (1964, p. 19).

Indeed, Friedman's Chicago predecessors were so firmly convinced that a fluctuating price level — in the face of a rigid cost structure — was the rationale of the business cycle, that further theoretical exploration was considered unnecessary. In this vein, Knight succinctly stated: "Too much attention has been given to this problem of the cause of the collapse" (1941, p. 214). Likewise, Simons observed: "I am strengthened in the conviction that the sooner we quit talking about business cycle theory as a major field of inquiry, the better" (1942, p. 186). And Mints argued that the study of the causal forces underlying upswings and downswings "is a matter of secondary importance" (1946, p. 60).

In contrast to the short shrift they gave the diagnosis of economic fluctuations, the aforementioned Chicago monetarists were preoccupied with the policy aspects of countering the cycle, and recent research supporting the relevance of that tradition appropriately stresses its policy orientation.⁵ Given the volatility of the price level and the consequently fluctuating velocity of circulation of money, economic stabilization was deemed to require discretionary variations in the money supply to maintain price-level stability. In the words of Knight: "An approximate constancy in general prices, or in the relation between product prices and wages, can in the nature of the case be achieved by deliberate action, based on constant attention, correcting or off-setting incipient tendencies to expansion or contraction" (1941, p. 224). Accordingly, in view of the overriding importance attached to regulation of the money stock in the pursuit of economic stability, the message emanating from the earlier Chicago tradition clearly was that the behavior of money did matter.

In turn, money behavior was also important in the neglected and largely isolated version of 1930s Chicago monetarism developed by Paul Douglas.⁶ Celebrated for his work on production functions, Douglas independently formulated a theory of the business cycle directly relevant to contemporaneous monetarist thought. Briefly summarized, Douglas, who in accord with his Chicago colleagues, used the Fisherine equation of exchange as his analytic framework, stressed the interdependence of the various terms within the equation. But unlike his colleagues who ascribed cycles to variations in

⁵ See DAVIS (1968; 1971), FRIEDMAN (1972), and TAVLAS (1976; 1977[a]; 1977 [b]).

⁶ A systematic discussion of DOUGLAS's monetary views is contained in his *Controlling Depressions* (1935). For additional references, see TAVLAS (1977 [b]).

velocity, Douglas argued that business fluctuations were caused by the failure of the money supply to increase proportionately with the secular rise in the production of goods. Thus, if the money stock expanded at a slower pace than production, prices would have to fall in order to permit the glut of goods in the market to be cleared. But because current product prices would embody relatively higher costs that were previously paid out, profit margins would fall and output would decline, thus triggering a recession. A conversely expansionary sequence would ensue, were the money stock to grow in excess of the secular pace of expansion in the production of goods. Hence, according to Douglas, the root cause of the business cycle was entirely a monetary one.

In consequence, Douglas held that economic stability necessitated reliance on either of two key indicators. Either the unemployment rate could be maintained within a certain range, or the price level could be kept stable. Attainment of either of these two goals could be achieved "if the quantity of purchasing power were to be increased at the rate of 3 to 4 percent a year, or the long-time rate of production" (1935, p. 185). This policy norm is, of course, strikingly reminiscent of the monetary growth-rate rule advocated by contemporary monetarists. Douglas originally espoused this norm in a 1927 paper on "The Modern Technique of Mass Production and its Relation to Wages" (1927, p. 40), and continued to do so in a series of writings culminating in his 1935 volume *Controlling Depressions*.

No similar advocacy of the monetary growth-rate rule, however, is to be found in the writings of Douglas's Chicago colleagues during the 1930s who opted instead for discretionary changes in the money stock. Additionally, Douglas broadened the quantity theory framework to incorporate such innovations as a Wicksell-Keynes savings-investment analysis, an accompanying multiplier mechanism à la Keynes-Kahn, and an accelerator principle in the vein of J.M. Clark. Such broadening of the quantity theory is not paralleled in the writings of Douglas's Chicago colleagues Simons, Knight, Mints, and Viner.

In sum, we have delineated the coexistence of two disparate threads of monetarism at Chicago during the 1930s. The Simon-Knight formulation relates to the contemporary quantity theory primarily in terms of the essential role assigned to money regulation as a stabilization device — with the important contrasting proviso that money regulation is to be discretionary. On the other hand, Douglas

is seen to anticipate more directly subsequent monetarist doctrine in terms of his monetary theory of the business cycle and in his seminal formulation of the monetary growth-rate rule.

The two diverse versions of the 1930s Chicago monetarism have in common several elements of fiscal and monetary policy. Indeed, as early as in 1927, Douglas has advocated the use of governmental budget deficits financed by money creation as a means to combat depressions. His argument was that traditional banking measures might fail during a depression because of the existence of low levels of confidence among both lenders and borrowers of funds. Since proper depression policy required an expansion of the supply of money so as to raise product prices and thereby profits, an alternative method of conducting monetary policy would be to create public-works projects financed by printing money. Douglas noted that bond-financed and tax-financed deficits were less desirable as they entail crowding-out effects.

The next Chicagoan to be associated with the advocacy of money-financed deficits as a depression tool was Aaron Director, who did so in 1931 (his first year on the Chicago faculty), in a volume which he coauthored with Douglas, titled *The Problem of Unemployment* (1931). In subsequent years two joint memoranda⁷ from Chicago were coauthored, both advocating the use of public works projects and money-financed deficits as essential antidepression policy. The rationale of the memoranda was entirely in accord with Douglas's 1927 paper: money creation-financed deficits would be effective because they would raise product prices faster than factor costs. The signatures of Douglas, Simons, and Viner appeared on both memoranda, while those of Director, Gideonse, Knight, and Mints appeared on either of the two. Given the similarity between the reasoning of these documents and the views that Douglas had been advancing as early as 1927, it is reasonable to infer that Douglas was primarily responsible for the Chicagoan advocacy of budget deficits during the early 1930s. Douglas, in turn, had accepted Simons's argument during this period concerning the disruptive influence of near-monies on economic stability as well as Simons's accompanying policy proposal of 100 percent reserve requirements.

⁷ See PETTINGILL (1932) and SMOOT (1933).

III. The Chicago Tradition and Ideology

The University of Chicago is widely regarded as a fulcrum for the espousal of the free-enterprise economy.⁸ This pre-eminent fosterage of the virtues of laissez-faire is traceable to the writings of Knight, Simons, Viner, and Mints during the 1930s. Concurrent, however, with the extolling of private enterprise by these economists was the contrary ideological pronouncement in the writings of Paul Douglas.

According to Douglas, the doctrine of laissez-faire was not as detached from material interests as its philosophical proponents were prone to argue. "On the contrary, it acquired dominance because the owners of industrial, commercial, and financial capital correctly judged that it would most favor them" (1933, p. 185). Hence, capitalistic governments had an inherent propertied-class proclivity:

Those who own the property in this country have an enormous advantage. They can withhold the use of their property but the worker cannot withhold very long the use of his labor (1932[b], p. 104).

Thus, challenging the norm of the neutral state enshrined in laissez-faire advocacy, Douglas contended that there was much truth in the Marxian claim that "we have in reality a class state which reflects the interests of the most powerful economic classes both in what it does and what it does not do in the fields of legislation, administration, and judicial opinion" (1933, p. 186). And though the working class could strike against the source of power, the existing political structure would assure the futility of such action. For:

there were always the police and the army upon whom the strong could call, and who, in the existing legal and political set-up, would hasten to respond (1933, p. 185).

The dominant classes might be advocates of laissez-faire in other matters, but they never proposed to disband the police or the army... The real question, therefore, is not whether government should participate in the social and economic life of our times, but for whom and how (1933, p. 185).

⁸ Discussions of the political philosophy of the Chicago School are provided in MILLER (1962), and MISHAN (1975). See also the comments on Miller's paper by BRONFENBRENNER (1962) and STIGLER (1962).

Douglas's ideological perception of capitalism in terms of what he viewed as its inherent class character was antithetical to the dominant Chicago view of the 1930s. Indeed, on at least one occasion Douglas averred that he was a socialist (1929, p. 508). Further consideration of several specific issues sheds added light on the underlying ideological schism that prevailed between Douglas and the other Chicago economists.

Issue A: The Labor Movement. According to the Simons-Knight business-cycle theory, changes in the general price level would be transformed into corresponding variations in profits and production because of the downward rigidity of the cost structure. Thus, Simons stated that "the existence of extreme inflexibility in large areas of the price structure is one of the primary factors in the phenomenon of severe depression" (1936, p. 54). Since the downward rigidity of costs was ascribed to the expanding labor movement, trade unions were constantly attacked by Chicagoans throughout the 1930s. So intense were these attacks, that it has recently been documented that Simons was subjected to delay in his promotion to full professor at the University of Chicago "due to the opposition of a dean who was incensed by Simons's attack on labor unions" (Stigler, 1974, p. 2). Moreover, the economic benefit of unions to the working class itself was denied by Chicagoans. For example, in 1932 Knight stated,

I submit that there is no greater wrong to laborers or to humanitarian progress than to encourage the belief that general wages are determined by bargaining position, or can be substantially raised by organization, even if *it possesses monopoly power* (original italics) (1932, p. 823).

In contrast to the foregoing line of interpretation, Douglas (1935) maintained that the severity of the Great Depression was experienced because real wages had not risen enough during the 1920s, rather than the other way around. Specifically, in his statistical work on production functions, Douglas found that costs had been declining throughout the 1920s while prices had been reduced only slightly. As a result, profits increased at a higher pace than real wages. Since profits accrue to employers who in turn invest them in mass-production industries, the consequence of higher profits can be

increased production of consumer goods. But profit recipients, he argued, spend only a small fraction of their profit incomes on mass-production goods, and a larger fraction on luxury goods and services. Hence, throughout the 1920s, commodity markets evinced a mounting glut of mass-production goods that could not be afforded by the working class because of the prevalence of low wages. In turn, had the general price level been allowed to decline gradually during the decade of the 1920s, the ensuing depression would not have been so severe. In this vein, Douglas linked-up his theory of the business cycle with his perception of the inferior position of wage-earners. He stated:

The present depression has caused many economists to ascribe both the origin and the continuance of the depression to the stickiness of wage rates in the face of falling prices (1935, p. 55).

(However) it is evident that at least in the United States high wage rates did not initiate the present depression, but that, on the contrary, the pegging of prices by management was largely responsible for both the initiation and the continuance of the depression... (1935, p. 64).

Accordingly, Douglas considered it imperative for laborers to organize. Labor unions, he thought, succeeded in imparting "to people who are individually weak a collectively greater strength so that in the wage market they stand in a position of better equality with employers" (1932 [b], p. 103). Union-organizing movements among wage earners would become more frequent, according to Douglas. "Instead of disparaging them, we should welcome them" (1932 [b], p. 98).

Issue B: Planning. A further object of scorn by Simons was what he designated the "mongrel system of 'national planning'". He deemed it "unlikely that any planners or controllers, with the peculiar talents requisite for obtaining dictatorial power, would be able to make decisions wise enough to keep an elaborate economic organization from falling apart" (1934, p. 52). Likewise, Knight criticized planning as an irresponsible overhauling and reconstruction of the social system (1933, pp. 421-22). Douglas, on the other hand, argued that "Society will have to take up sooner or later a planned economy" (1932 [b], p. 108). Planning, he thought, would allow

society to enjoy "great areas of forests and parks on the outside of every one of our cities [and] more decent housing within our cities" (1932 [b], p. 107).

Issue C: The Reconstruction Finance Corporation. Both Simons and Douglas opposed the Reconstruction Finance Corporation established by the U.S. Government during the Great Depression to rescue faltering enterprises. But whereas Simons thought it "terrifying to reflect on the amount of arbitrary power delegated to the administrators of the R.F.C., and thus viewed it as a means of fostering monopolistic pricing (1934, p. 322), Douglas, in typical fashion, opposed it because of its "class character". The R.F.C., according to Douglas, was created "in order to buoy up the propertied classes" (1932, [a], p. 80).

IV. The Emergence of Chicago Monetarism

During the early 1930s an intense cleavage developed between Douglas, on the one hand, and Simons and Knight on the other. Thus, beginning in 1932 and for some time thereafter, Douglas strenuously opposed renewal of Simons's appointment on the Chicago faculty.⁹ Simons's staunchest defender against Douglas was Knight. As the 1930s wore on, Douglas increasingly took refuge in local politics in the ranks of the Democratic Party. In the early 1940s he departed Chicago on academic leave and volunteered for wartime service in the U.S. Marine Corps. Upon his postwar return to the University, he found that ideological conservatives had attained an almost total dominance of this department. The doctrine of laissez-faire did not square well with the economist who in 1933 had argued that "society (should) move sooner or later into a system of public ownership rather than backward into unrestrained competition" (1933, p. 191). His thoughts on returning to Chicago are noteworthy:

The university I had loved so much seemed to be a different place... Knight was now openly hostile, and his disciples seemed to be everywhere. If I had stayed, it would be in an unfriendly environment. I felt stifled and did not think I could live in that atmosphere. My emotions turned outward and not inward. (1972, p. 128).

⁹ See STIGLER (1974).

As a result, Douglas successfully campaigned as a candidate for the U.S. Senate in 1948. Significantly, he continued to champion the quantity theory of money as a senator, and became a moving force in the Congress behind the Treasury-Federal Reserve Accord of 1951.¹⁰

Thus, at the very least, Douglas's simultaneous adherence to the quantity theory and to left-wing ideology is a direct challenge to the facile presumption of conflict between the two. It is plainly undeniable that the quantity theory that found consensus in Chicago during the 1930s was underlain by an ideological battle of Douglas versus Knight and Simons. The latter two gained the upper hand with the consequence that Douglas filled a less and less active role in his department during the late 1930s and eventually took permanent leave of Chicago altogether. In turn, the theory of money that is identified with Chicago of the 1930s has come to be viewed in splendid isolation of the left-wing ideology of which Paul Douglas was a consistent adherent. Yet when brought to the fore, the case of Douglas versus Knight and Simons illustrates the compatibility of monetarism with varied segments of the ideological spectrum within Chicago and without.

V. Keynesian Anti-Monetarism: The Case of Kaldor

Since Keynes's *General Theory*, it has become axiomatic that fiscalism or Keynesianism, poses an ideological, and not only a logical, challenge to monetarism. Certainly Keynes's own espousal of the socialization of investment (1936, p. 378) as a suggested reform in economic policy-making was bound to be perceived as implying rejection of a laissez-faire political economy. But whether Keynesian monetary analysis as a rival to Chicago monetarism implies such rejection is an open question, albeit a tenet of conventional wisdom that Keynesianism is tantamount to welfare statism. It is, therefore, instructive to consider the case of Nicholas Kaldor, a leading fiscalist or Keynesian, whose anti-monetarist analysis has been noted and directly rebutted by Friedman (1970 [b]).

In terms of ideology, Kaldor is evidently an anti-laissez-faire, British left-wing adherent. That his political-economy orientation contrasts, if it does not clash, with the ideology of American liberta-

¹⁰ Douglas's role in initiating the Treasury-Federal Reserve Accord is discussed in TAVLAS (1977[b]).

rianism as well as of conservatism, is beyond question. Suffice it to note that while Keynes himself was officially a Liberal (Party) Lord, the Keynesian Kaldor is a Labour (Party) Lord. Yet consider Kaldor's anti-monetarist analysis in terms of the demand function for money, the nature of money, the velocity of circulation of money, and the variability of the money supply. Though on all these counts Kaldor differs with Friedman openly and directly, does Kaldor's monetary analysis as such presuppose or imply a leftist ideology?

In challenging Friedman's proposition of the existence of a stable demand function for money, Kaldor first probes the economic basis for the presence of seasonal variation of currency in circulation. Regarding the rise of currency at Christmas time, he asks: "Could the 'authorities' prevent the [Christmas] buying spree by refusing to supply additional notes and coins in the Christmas season?" (1970, p. 6). If the central bank deliberately attempted to do so, retorts Kaldor, it could instruct banks not to cash more than a specified amount at any one time for each customer and to keep down the number of cashiers at Christmas time so as to drastically lengthen the queues for cash at bank tellers' windows. But would such measures stop the Christmas buying spree? No, answers Kaldor: "There would be chaos for a few days, but all kinds of money substitutes would spring up: credit cards, promissory notes, etc., issued by firms and financial institutions which would circulate in the same way as bank notes. Any business with a high reputation — a well-known firm which is universally trusted — could issue such paper, and anyone who could individually be 'trusted' would get things on 'credit'" (1970, p. 6). Others, such as the mass of wage-earners who might have no credit, continues Kaldor, "would get paid in chits which would be issued in lieu of cash by, say, the top five hundred businesses in the country (who would also, for a consideration, provide such chits to other employers). And these five hundred firms would soon find it convenient to set up a clearing system of their own, by investing in a giant computer which would at regular intervals net out all mutual claims and liabilities" (1970, p. 7). The upshot of such spontaneous adaptation of the private sector to the central bank's attempt to suppress the upsurge in the volume of currency in circulation at Christmas time, according to Kaldor, is, therefore, the emergence of "a complete surrogate money system and payments system" that "would exist side by side with official money" (1970, p. 7).

Thus, what at any time is regarded as "money", maintains Kaldor, "are those forms of financial claims which are commonly used as means of clearing debts. But any shortage of commonly used types is bound to lead to the emergence of new types; indeed, this is how, historically, first bank notes and then checking accounts emerged" (1970, p. 7). Hence, Kaldor concludes that "When the central bank succeeds in controlling the quantity of 'conventional money', lending and borrowing is diverted to other sources, and the 'velocity of circulation', in terms of conventional money, is automatically speeded up" (1970, p. 8).

Addressing himself to Friedman's claim that the velocity of circulation of conventional money has been relatively stable empirically, Kaldor readily concurs. His reason, however, is that in the historical periods analyzed by Friedman, the supply of money was unstable. In Kaldor's words: "in one way or another an increased demand for money evoked an increase in supply. The money supply 'accommodated itself' to the needs of trade: rising in response to an expansion, and vice versa" (1970, p. 8).

In sum, Kaldor's retort to Friedman's stability of the demand function for money is that the money supply is endogenous, not exogenous.¹¹ In turn, the monetary base, according to Kaldor is itself automatically responsive to changes in the demand for money: "if variations in the money supply were closely related to changes in the 'monetary base', this is mainly because the latter has also been 'endogenous', as well as the former" (1970, p. 12).

It turns out that Kaldor's anti-monetarist monetary analysis is itself rooted in his attribution to the initiative, drive and spontaneity of the private sector, under the leadership of financial and non-financial private enterprises, the capacity to supply money in creative response to the private sector's demand for money. Kaldor's anti-monetarism or anti-Friedmanism is thus grounded in the conception of a profit-oriented private enterprise, nay, a laissez-faire analysis of the nature and behavior of a monetary economy. Manifestly, whatever his political ideology, Kaldor's anti-monetarist monetary analysis does not presuppose or imply socialism, communism or welfare statism. It is as readily reconcilable with a laissez-faire political economy as monetarism itself.

¹¹ KALDOR expresses a similar view concerning the endogeneity of the money supply in his article on the "The Radcliffe Report" (1960).

VI. Non-Monetarism and Laissez-Faire

Finally, we turn to the question of the relationship between professed laissez-faire adherence and monetarism. Having found that monetarists need not be laissez-faire adherents, and that anti-monetarists need not be laissez-faire opponents, we now query: do laissez-faire proponents need to be monetarists?

In the camp of contemporary laissez-faire proponents, the preeminence of the University of Chicago has been noted previously in this paper. The fact of this preeminence is widely perceived as suggesting that laissez-faire adherence connotes monetarism. Our task is to probe this laissez-faire-monetarism nexus.

As would be expected, the contemporary laissez-faire camp itself meets the test of laissez-faire in monetary analysis. In other words, despite the preeminence of the University of Chicago among both monetarists and laissez-faire adherents, the laissez-faire camp is not limited exclusively to monetarists. Two non-monetarist strands of monetary analysis coexist with monetarism in the camp of laissez-faire ideology. Though distinguishable from each other, the two non-monetarist strands of thought share a major analytical feature as a point of emphasis: the treatment of money as an international (i.e., open-economy) phenomenon. Monetarism itself is fully reconcilable with an open-economy analytical framework, as recent work by Johnson¹² effectively illustrates. Yet the conceptually seminal development of monetarism has not featured the open-economy framework as have the non-monetarist strands of thought to be considered.

A. *Metallism.* A time-honored non-monetarist conception of optimality in the supply of money propounded by some outstanding laissez-faire advocates is that of precious metallism: the classical specie-flow mechanism. The line of reasoning here involved, derives from the proposition that the preservation of voluntary exchange, and, therefore, of private property, is ultimately contingent upon the monetary stability that only a specie-based monetary system is deemed capable of imparting. This proposition finds its clearest expression in terms of the von Mises-Rothbard money-regression theorem: A medium of exchange "can arise only out of a commodity previously *used directly in*

¹² See, for example, JOHNSON (1977).

a barter situation, and therefore having had an array of prices in terms of other goods. *Money must develop out of a commodity with a previously existing purchasing power, such as gold and silver had.* It cannot be created out of thin air by any sudden 'social compact' or edict of government'' (original italics), (Rothbard, 1962, pp. 235-36).

Thus, fiat money, in this laissez-faire view, is inherently the product of an authoritarian or collectivist state. As such, fiat money is inconsistent with the role of the state as preserver of the viability of private property. Hence the policy norms that monetarism would provide for a fiat-money economy are themselves considered as contrary to the rules of the game required for restoration of the classical specie-flow mechanism. Such metallism advocates, therefore, regard monetarism as undermining the application of laissez-faire economics to the monetary system.

Yet remarkably enough, while proponents of restoration of the gold standard are typically laissez-faire advocates, there is no presumptive basis for barring laissez-faire opponents from gold-standard advocacy as well. Thus, presiding over French indicative planning as a convinced dirigiste, General Charles de Gaulle delivered a paean to gold so ardent that it has been aptly depicted as "perhaps the most remarkable lecture in monetary economics ever mouthed by a head of state" (Hirsch, 1969, pp. 258-59).

B. Functionalism. A contemporary non-monetarist conception of a monetary regime diverging from the von Mises-Rothbard metallist approach but likewise sharing the voluntary-exchange tenet of laissez-faire advocacy has been stimulated by the international monetary developments ensuing from the Smithsonian Agreement of 1971. Applying the theory of the second-best, this conception focuses upon the emergence of abstract international units of account (numeraires) introduced at will by private enterprises as well as by national governments and international organizations, units depicted by Aschheim and Park (1976) as "artificial currency units". The transformation of such units of account into media of exchange is here viewed as an experimental process in the emergence of functional currency areas whereby a variety of ACUs come into being and coexist, each tailor-made for the range of international and national exchange transactions that its sponsor seeks to enhance.

The Aschheim-Park concept of the formation of functional cur-

rency areas implies a regime of laissez-faire or do-it-yourself monies within the private sector. Yet it also recognizes the capacity of national governments and international governmental organizations to participate in the ACU proliferation process for both economic and political reasons of their own.

Perhaps the foremost laissez-faire proponent in the world, Friedrich A. Hayek has recently espoused the notion of private-money proliferation as an integral part of his laissez-faire advocacy (1976; 1977). Specifically, Hayek proposes allowing private individuals to print money instead of the governments, and letting the public decide whose money is the most valuable. Hayek's propounding this proposal is vivid testimony to the pluralism of non-monetarism among laissez-faire advocates. Clearly, laissez-faire ideology is not the exclusive domain of monetarists any more than monetarism is the exclusive domain of laissez-faire ideologists.

VII. Concluding Remarks

This paper has examined: (a) the relationship between monetarism and ideology; and (b) the relationship between non-monetarism and ideology. The identification of two coexisting strands of 1930s Chicago monetarism, distinguished in terms of business-cycle theory and stabilization policy, provides the basis for the suggestion that monetarism is not the exclusive domain of conservatism. Furthermore, the delineation of the ideological battle during the 1930s and 1940s between Chicago monetarists Frank Knight and Henry Simons, on the one hand, and Paul Douglas, on the other, highlights the subsequent emergence of Chicago monetarism in association with right-wing ideology.

In turn, non-monetarism or even anti-monetarism is also found to encompass a diversity of approaches to monetary economics with no single ideological connotation as the overriding one. It is demonstrated that a Keynesian monetary analysis does not necessarily presuppose or imply opposition to a laissez-faire political economy. On the other hand, a non-Keynesian challenge to monetarism, whether of the precious-metallism or of the international-functionalism variety, is seen to be reconcilable with more than one ideological preference.

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