receipt for a tax which anyone who wishes to enter the activity may pay.

10. So-called "public-housing" and the host of other subsidy programs directed at fostering residential construction such as F.H.A. and V.A. guarantee of mortgage, and the like.

11. Conscription to man the military services in peacetime. The appropriate free market arrangement is volunteer military forces; which is to say, hiring men to serve. There is no justification for not paying whatever price is necessary to attract the required number of men. Present arrangements are inequitable and arbitrary, seriously interfere with the freedom of young men to shape their lives, and probably are even more costly than the market alternative. (Universal military training to provide a reserve for war time is a different problem and may be justified on liberal grounds.)

12. National parks, as noted above.

13. The legal prohibition on the carrying of mail for profit.

14. Publicly owned and operated toll roads, as noted above.

This list is far from comprehensive.

Chapter III

The Control of Money

"FULL EMPLOYMENT" and "economic growth" have in the past few decades become primary excuses for widening the extent of government intervention in economic affairs. A private free-enterprise economy, it is said, is inherently unstable. Left to itself, it will produce recurrent cycles of boom and bust. The government must therefore step in to keep things on an even keel. These arguments were particularly potent during and after the Great Depression of the 1930's, and were a major element giving rise to the New Deal in this country and comparable extensions of governmental intervention in others. More recently, "economic growth" has become the more popular rallying call. Government must, it is argued, see to it that the economy expands to provide the wherewithal for the cold war and demonstrate to

the uncommitted nations of the world that a democracy can grow more rapidly than a communist state.

These arguments are thoroughly misleading. The fact is that the Great Depression, like most other periods of severe unemployment, was produced by government mismanagement rather than by any inherent instability of the private economy. A governmentally established agency — the Federal Reserve System — had been assigned responsibility for monetary policy. In 1930 and 1931, it exercised this responsibility so ineptly as to convert what otherwise would have been a moderate contraction into a major catastrophe (see further discussion, pages 45–50, below). Similarly today, governmental measures constitute the major impediments to economic growth in the United States. Tariffs and other restrictions on international trade, high tax burdens and a complex and inequitable tax structure, regulatory commissions, government price and wage fixing, and a host of other measures give individuals an incentive to misuse and misdirect resources, and distort the investment of new savings. What we urgently need, for both economic stability and growth, is a reduction of government intervention not an increase.

Such a reduction would still leave an important role for government in these areas. It is desirable that we use government to provide a stable monetary framework for a free economy — this is part of the function of providing a stable legal framework. It is desirable too that we use government to provide a general legal and economic framework that will enable individuals to produce growth in the economy, if that is in accord with their values.

The major areas of governmental policy that are relevant to economic stability are monetary policy and fiscal or budgetary policy. This chapter discusses domestic monetary policy, the next, international monetary arrangements, and chapter v, fiscal or budgetary policy.

Our task in this and the following chapter is to steer a course between two views, neither of which is acceptable though both have their attractions. The Scylla is the belief that a purely automatic gold standard is both feasible and desirable and would resolve all the problems of fostering economic co-operation

among individuals and nations in a stable environment. The Charybdis is the belief that the need to adapt to unforeseen circumstances requires the assignment of wide discretionary powers to a group of technicians, gathered together in an "independent" central bank, or in some bureaucratic body. Neither has proved a satisfactory solution in the past; and neither is likely to in the future.

A liberal is fundamentally fearful of concentrated power. His objective is to preserve the maximum degree of freedom for each individual separately that is compatible with one man's freedom not interfering with other men's freedom. He believes that this objective requires that power be dispersed. He is suspicious of assigning to government any functions that can be performed through the market, both because this substitutes coercion for voluntary co-operation in the area in question and because, by giving government an increased role, it threatens freedom in other areas.

The need for the dispersal of power raises an especially difficult problem in the field of money. There is widespread agreement that government must have some responsibility for monetary matters. There is also widespread recognition that control over money can be a potent tool for controlling and shaping the economy. Its potency is dramatized in Lenin's famous dictum that the most effective way to destroy a society is to destroy its money. It is exemplified in more pedestrian fashion by the extent to which control of money has, from time immemorial, enabled sovereigns to exact heavy taxes from the populace at large, very often without the explicit agreement of the legislature when there has been one. This has been true from early times when monarchs clipped coins and adopted similar expedients to the present with our more sophisticated modern techniques for turning the printing press or simply altering book entries. The problem is to establish institutional arrangements that will enable government to exercise responsibility for money, yet at the same time limit the power thereby given to government and prevent this power from being used in ways that will tend to weaken rather than strengthen a free society.

A COMMODITY STANDARD

Historically, the device that has evolved most frequently in many different places and over the course of centuries is a commodity standard; i.e., the use as money of some physical commodity such as gold or silver, brass or tin, cigarettes or cognac, or various other goods. If money consisted wholly of a physical commodity of this type, there would be, in principle, no need for control by the government at all. The amount of money in society would depend on the cost of producing the monetary commodity rather than other things. Changes in the amount of money would depend on changes in the technical conditions of producing the monetary commodity and on changes in the demand for money. This is an ideal that animates many believers in an automatic gold standard.

Actual commodity standards have deviated very far from this simple pattern which requires no governmental intervention. Historically, a commodity standard — such as a gold standard or a silver standard — has been accompanied by the development of fiduciary money of one kind or another, ostensibly convertible into the monetary commodity on fixed terms. There was a very good reason for this development. The fundamental defect of a commodity standard, from the point of view of the society as a whole, is that it requires the use of real resources to add to the stock of money. People must work hard to dig gold out of the ground in South Africa — in order to rebury it in Fort Knox or some similar place. The necessity of using real resources for the operation of a commodity standard establishes a strong incentive for people to find ways to achieve the same result without employing these resources. If people will accept as money pieces of paper on which is printed "I promise to pay —— units of the commodity standard," these pieces of paper can perform the same function as the physical pieces of gold or silver, and they require very much less in resources to produce. This point, which I have discussed at somewhat greater length elsewhere,[1] seems to me the fundamental difficulty with a commodity standard.

If an automatic commodity standard were feasible, it would provide an excellent solution to the liberal's dilemma: a stable

[1] *A Program for Monetary Stability* (New York: Fordham University Press, 1959) pp. 4–8.

monetary framework without the danger of the irresponsible exercise of monetary powers. If, for example, an honest-to-goodness gold standard, in which 100 per cent of the money in a country consisted literally of gold, were widely backed by the public at large, imbued with the mythology of a gold standard and with the belief that it is immoral and improper for government to interfere with its operation, it would provide an effective guarantee against governmental tinkering with the currency and against irresponsible monetary action. Under such a standard, any monetary powers of government would be very minor in scope. But, as just noted, such an automatic system has historically never proved feasible. It has always tended to develop in the direction of a mixed system containing fiduciary elements such as bank notes and deposits, or government notes in addition to the monetary commodity. And once fiduciary elements have been introduced, it has proved difficult to avoid governmental control over them, even when they were initially issued by private individuals. The reason is basically the difficulty of preventing counterfeiting or its economic equivalent. Fiduciary money is a contract to pay standard money. It so happens that there tends to be a long interval between the making of such a contract and its realization. This enhances the difficulty of enforcing the contract and hence also the temptation to issue fraudulent contracts. In addition, once fiduciary elements have been introduced, the temptation for government itself to issue fiduciary money is almost irresistible. In practice, therefore, commodity standards have tended to become mixed standards involving extensive intervention by the state.

It should be noted that despite the great amount of talk by many people in favor of the gold standard, almost no one today literally desires an honest-to-goodness, full gold standard. People who say they want a gold standard are almost invariably talking about the present kind of standard, or the kind of standard that was maintained in the 1930's; a gold standard managed by a central bank or other governmental bureau, which holds a small amount of gold as "backing" — to use that very misleading term — for fiduciary money. Some do go so far as to favor the kind of standard maintained in the 1920's, in which there was literal circulation of gold or gold certificates as hand-to-hand

currency — a gold-coin standard — but even they favor the coexistence with gold of governmental fiduciary currency plus deposits issued by banks holding fractional reserves in either gold or fiduciary currency. Even during the so-called great days of the gold standard in the nineteenth century, when the Bank of England was supposedly running the gold standard skilfully, the monetary system was far from a fully automatic gold standard. Even then it was a highly managed standard. And certainly the situation is now more extreme as a result of the adoption by country after country of the view that government has responsibility for "full employment."

My conclusion is that an automatic commodity standard is neither a feasible nor a desirable solution to the problem of establishing monetary arrangements for a free society. It is not desirable because it would involve a large cost in the form of resources used to produce the monetary commodity. It is not feasible because the mythology and beliefs required to make it effective do not exist.

This conclusion is supported not only by the general historical evidence referred to but also by the specific experience of the United States. From 1879, when the United States resumed gold payments after the Civil War, to 1913, the United States was on a gold standard. Though closer to a thoroughly automatic gold standard than anything we have had since the end of World War I, the gold standard was still far from a 100 per cent gold standard. There were government issues of paper money, and private banks issued most of the effective circulating medium of the country in the form of deposits; the banks were closely regulated in their operations by governmental agencies — national banks by the Comptroller of the Currency, state banks by state banking authorities. Gold, whether held by the Treasury, by banks, or directly by individuals as coins or gold certificates, accounted for between 10 per cent and 20 per cent of the money stock, the exact percentage varying from year to year. The remaining 80 per cent to 90 per cent consisted of silver, fiduciary currency, and bank deposits not matched by gold reserves.

In retrospect, the system may seem to us to have worked reasonably well. To Americans of the time, it clearly did not. The agitation over silver in the 1880's, culminating in Bryan's Cross of Gold speech which set the tone for the 1896 election, was one sign of dissatisfaction. In turn, the agitation was largely responsible for the severely depressed years in the early 1890's. The agitation led to widespread fears that the United States would go off gold and that hence the dollar would lose value in terms of foreign currencies. This led to a flight from the dollar and a capital outflow that forced deflation at home.

Successive financial crises, in 1873, 1884, 1890, and 1893 produced a widespread demand for banking reform on the part of the business and banking community. The panic of 1907, involving the concerted refusal by banks to convert deposits into currency on demand, finally crystallized the feeling of dissatisfaction with the financial system into an urgent demand for governmental action. A National Monetary Commission was established by Congress, and its recommendations, reported in 1910, were embodied in the Federal Reserve Act passed in 1913. Reforms along the lines of the Federal Reserve Act had the backing of every section of the community, from the working classes to the bankers, and of both political parties. The chairman of the National Monetary Commission was a Republican, Nelson W. Aldrich; the Senator mainly responsible for the Federal Reserve Act was a Democrat, Carter W. Glass.

The change in monetary arrangements introduced by the Federal Reserve Act turned out in practice to be far more drastic than was intended by its authors or its supporters. At the time the Act was passed, a gold standard reigned supreme throughout the world — not a fully automatic gold standard but something far closer to that ideal than anything we have experienced since. It was taken for granted that it would continue to do so and thus narrowly limit the powers of the Federal Reserve System. No sooner was the Act passed than World War I broke out. There was a large-scale abandonment of the gold standard. By the end of the war, the Reserve System was no longer a minor adjunct to the gold standard designed to insure the convertibility of one form of money into others and to regulate and supervise banks. It had become a powerful discretionary author-

ity able to determine the quantity of money in the United States and to affect international financial conditions throughout the world.

A DISCRETIONARY MONETARY AUTHORITY

The establishment of the Federal Reserve System was the most notable change in United States monetary institutions since at least the Civil War National Banking Act. For the first time since the expiration of the charter of the Second Bank of the United States in 1836, it established a separate official body charged with explicit responsibility for monetary conditions, and supposedly clothed with adequate power to achieve monetary stability or, at least, to prevent pronounced instability. It is therefore instructive to compare experience as a whole before and after its establishment — say, from just after the Civil War to 1914 and from 1914 to date, to take two periods of equal length.

The second period was clearly the more unstable economically, whether instability is measured by the fluctuations in the stock of money, in prices, or in output. Partly, the greater instability reflects the effect of two world wars during the second period; these would clearly have been a source of instability whatever our monetary system. But even if the war and immediate postwar years are omitted, and we consider only the peacetime years from, say, 1920 through 1939, and 1947 to date, the result is the same. The stock of money, prices, and output was decidedly more unstable after the establishment of the Reserve System than before. The most dramatic period of instability in output was of course the period between the two wars which includes the severe contractions of 1920–21, 1929–33, and 1937–38. No other twenty-year period in American history contains as many as three such severe contractions.

This crude comparison does not of course prove that the Federal Reserve System failed to contribute to monetary stability. Perhaps the problems that the System had to handle were more severe than those that impinged on the earlier monetary structure. Perhaps those problems would have produced an even greater degree of monetary instability under the earlier arrangements. But the crude comparison should at least give the reader

pause before he takes for granted, as is so often done, that an agency as long established, as powerful, as pervasive as the Federal Reserve System is performing a necessary and desirable function and is contributing to the attainment of the objectives for which it was established.

I am myself persuaded, on the basis of extensive study of the historical evidence, that the difference in economic stability revealed by the crude comparison is in fact attributable to the difference in monetary institutions. This evidence persuades me that at least a third of the price rise during and just after World War I is attributable to the establishment of the Federal Reserve System and would not have occurred if the earlier banking system had been retained; that the severity of each of the major contractions — 1920–21, 1929–33, and 1937–38 — is directly attributable to acts of commission and omission by the Reserve authorities and would not have occurred under earlier monetary and banking arrangements. There might well have been recessions on these or other occasions, but it is highly unlikely that any would have developed into a major contraction.

I clearly cannot present this evidence here.[2] However, in view of the importance which the Great Depression of 1929–33 played in forming — or, I would say, deforming — general attitudes toward the role of government in economic affairs, it may be worth indicating more fully for this episode the kind of interpretation suggested by the evidence.

Because of its dramatic character, the stock market crash in October, 1929, which terminated the bull market of 1928 and 1929 is often regarded as both the start and the major proximate cause of the Great Depression. Neither is correct. The peak of business was reached in mid-1929, some months prior to the crash. The peak may well have come as early as it did partly as a result of relatively tight money conditions imposed by the Federal Reserve System in an attempt to curb "speculation" — in this indirect way, the stock market may have played a role in bringing about the contraction. The stock market crash in turn undoubtedly had some indirect effects on business confidence

[2] See my *A Program for Monetary Stability* and Milton Friedman and Anna J. Schwartz, *A Monetary History of the United States, 1867–1960* (forthcoming by Princeton University Press for the National Bureau of Economic Research).

and on the willingness of individuals to spend which exerted a depressing influence on the course of business. But by themselves, these effects could not have produced a collapse in economic activity. At most, they would have made the contraction somewhat longer and more severe than the usual mild recessions that have punctuated American economic growth throughout our history; they would not have made it the catastrophe it was.

For something like the first year, the contraction showed none of those special features that were to dominate its later course. The economic decline was more severe than during the first year of most contractions, possibly in response to the stock market crash plus the unusually tight monetary conditions that had been maintained since mid-1928. But it showed no qualitatively different characteristics, no signs of degenerating into a major catastrophe. Except on naïve *post hoc ergo propter hoc* reasoning, there is nothing in the economic situation as it stood in, say, September or October, 1930 that made the continued and drastic decline of the following years inevitable or even highly probable. In retrospect, it is clear that the Reserve System should already have been behaving differently than it did, that it should not have allowed the money stock to decline by nearly 3 per cent from August 1929 to October 1930—a larger decline than during the whole of all but the most severe prior contractions. Though this was a mistake, it was perhaps excusable, and certainly not critical.

The character of the contraction changed drastically in November 1930, when a series of bank failures led to widespread runs on banks, which is to say attempts by depositors to convert deposits into currency. The contagion spread from one part of the country to another and reached a climax with the failure on December 11, 1930 of the Bank of the United States. This failure was critical not only because the Bank was one of the largest in the country, with over $200 million in deposits, but also because, though an ordinary commercial bank, its name had led many both at home and even more abroad to regard it as somehow an official bank.

Prior to October, 1930, there had been no sign of a liquidity crisis, or any loss of confidence in banks. From this time on,

the economy was plagued by recurrent liquidity crises. A wave of bank failures would taper down a while, and then start up again as a few dramatic failures or other events produced a new loss of confidence in the banking system and a new series of runs on banks. These were important not only or even primarily because of the failures of the banks but because of their effect on the money stock.

In a fractional reserve banking system like ours, a bank does not of course have a dollar of currency (or its equivalent) for a dollar of deposits. That is why "deposits" is such a misleading term. When you deposit a dollar of cash in a bank, the bank may add fifteen or twenty cents to its cash; the rest it will lend out through another window. The borrower may in turn redeposit it, in this or another bank, and the process is repeated. The result is that for every dollar of cash owned by banks, they owe several dollars of deposits. The total stock of money—cash plus deposits—for a given amount of cash is therefore higher the larger the fraction of its money the public is willing to hold as deposits. Any widespread attempt on the part of depositors to "get their money" must therefore mean a decline in the total amount of money unless there is some way in which additional cash can be created and some way for banks to get it. Otherwise, one bank, in trying to satisfy its depositors, will put pressure on other banks by calling loans or selling investments or withdrawing its deposits and these other banks in turn will put pressure on still others. The vicious cycle, if allowed to proceed, grows on itself as the attempt of banks to get cash forces down the prices of securities, renders banks insolvent that would otherwise have been entirely sound, shakes the confidence of depositors, and starts the cycle over again.

This was precisely the kind of a situation that had led to a banking panic under the pre-Federal-Reserve banking system, and to a concerted suspension of the convertibility of deposits into currency, as in 1907. Such a suspension was a drastic step and for a short while made matters worse. But it was also a therapeutic measure. It cut short the vicious cycle by preventing the spread of the contagion, by keeping the failure of a few banks from producing pressure on other banks and leading to

the failure of otherwise sound banks. In a few weeks or months, when the situation had stabilized, the suspension could be lifted, and recovery begin without monetary contraction.

As we have seen, one of the major reasons for establishing the Federal Reserve System was to deal with such a situation. It was given the power to create more cash if a widespread demand should arise on the part of the public for currency instead of deposits, and was given the means to make the cash available to banks on the security of the bank's assets. In this way, it was expected that any threatened panic could be averted, that there would be no need for suspension of convertibility of deposits into currency, and that the depressing effects of monetary crises could be entirely avoided.

The first need for these powers and hence the first test of their efficacy came in November and December of 1930 as a result of the string of bank closings already described. The Reserve System failed the test miserably. It did little or nothing to provide the banking system with liquidity, apparently regarding the bank closings as calling for no special action. It is worth emphasizing, however, that the System's failure was a failure of will, not of power. On this occasion, as on the later ones that followed, the System had ample power to provide the banks with the cash their depositors were demanding. Had this been done, the bank closings would have been cut short and the monetary debacle averted.

The initial wave of bank failures died down and in early 1931 there were signs of returning confidence. The Reserve System took advantage of the opportunity to reduce its own credit outstanding — which is to say, it offset the naturally expansionary forces by engaging in mild deflationary action. Even so, there were clear signs of improvement not only in the monetary sector but also in other economic activities. The figures for the first four or five months of 1931, if examined without reference to what actually followed, have all the earmarks of the bottom of a cycle and the beginning of revival.

The tentative revival was however short-lived. Renewed bank failures started another series of runs and again set in train a renewed decline in the stock of money. Again, the Reserve System stood idly by. In the face of an unprecedented liquidation

of the commercial banking system, the books of the "lender of last resort" show a *decline* in the amount of credit it made available to its member banks.

In September 1931, Britain went off the gold standard. This act was preceded and followed by gold withdrawals from the United States. Although gold had been flowing into the United States in the prior two years, and the U.S. gold stock and the Federal Reserve gold reserve ratio were at an all time high, the Reserve System reacted vigorously and promptly to the external drain as it had not to the previous internal drain. It did so in a manner that was certain to intensify the internal financial difficulties. After more than two years of severe economic contraction, the System raised the discount rate — the rate of interest at which it stood ready to lend to member banks — more sharply than it has within so brief a period in its whole history before or since. The measure arrested the gold drain. It was also accompanied by a spectacular increase in bank failures and runs on banks. In the six months from August 1931 through January 1932, roughly one out of ten banks in existence suspended operations and total deposits in commercial banks fell by 15 per cent.

A temporary reversal of policy in 1932 involving the purchase of $1 billion of government bonds slowed down the rate of decline. Had this measure been taken in 1931, it would almost surely have been sufficient to prevent the debacle just described. By 1932, it was too late to be more than a palliative and, when the System relapsed into passivity, the temporary improvement was followed by a renewed collapse terminating in the Banking Holiday of 1933 — when every bank in the United States was officially closed for over a week. A system established in large part to prevent a temporary suspension of convertibility of deposits into currency — a measure that had formerly prevented banks from failing — first let nearly a third of the banks of the country go out of existence and then welcomed a suspension of convertibility that was incomparably more sweeping and severe than any earlier suspension. Yet so great is the capacity for self-justification that the Federal Reserve Board could write in its annual report for 1933, "The ability of the Federal Reserve Banks to meet enormous demands for currency during the crisis demonstrated the effectiveness of the country's currency

system under the Federal Reserve Act. . . . It is difficult to say what the course of the depression would have been had the Federal Reserve System not pursued a policy of liberal open market purchases."

All told, from July 1929 to March 1933, the money stock in the United States fell by one-third, and over two-thirds of the decline came after England's departure from the gold standard. Had the money stock been kept from declining, as it clearly could and should have been, the contraction would have been both shorter and far milder. It might still have been relatively severe by historical standards. But it is literally inconceivable that money income could have declined by over one-half and prices by over one-third in the course of four years if there had been no decline in the stock of money. I know of no severe depression in any country or any time that was not accompanied by a sharp decline in the stock of money and equally of no sharp decline in the stock of money that was not accompanied by a severe depression.

The Great Depression in the United States, far from being a sign of the inherent instability of the private enterprise system, is a testament to how much harm can be done by mistakes on the part of a few men when they wield vast power over the monetary system of a country.

It may be that these mistakes were excusable on the basis of the knowledge available to men at the time—though I happen to think not. But that is really beside the point. Any system which gives so much power and so much discretion to a few men that mistakes—excusable or not—can have such far-reaching effects is a bad system. It is a bad system to believers in freedom just because it gives a few men such power without any effective check by the body politic—this is the key political argument against an "independent" central bank. But it is a bad system even to those who set security higher than freedom. Mistakes, excusable or not, cannot be avoided in a system which disperses responsibility yet gives a few men great power, and which thereby makes important policy actions highly dependent on accidents of personality. This is the key technical argument against an "independent" bank. To

paraphrase Clemenceau, money is much too serious a matter to be left to the Central Bankers.

RULES INSTEAD OF AUTHORITIES

If we can achieve our objectives neither by relying on the working of a thoroughly automatic gold standard nor by giving wide discretion to independent authorities, how else can we establish a monetary system that is stable and at the same time free from irresponsible governmental tinkering, a system that will provide the necessary monetary framework for a free enterprise economy yet be incapable of being used as a source of power to threaten economic and political freedom?

The only way that has yet been suggested that offers promise is to try to achieve a government of law instead of men by legislating rules for the conduct of monetary policy that will have the effect of enabling the public to exercise control over monetary policy through its political authorities, while at the same time it will prevent monetary policy from being subject to the day-by-day whim of political authorities.

The issue of legislating rules for monetary policy has much in common with a topic that seems at first altogether different, namely, the argument for the first amendment to the Constitution. Whenever anyone suggests the desirability of a legislative rule for control over money, the stereotyped answer is that it makes little sense to tie the monetary authority's hands in this way because the authority, if it wants to, can always do of its own volition what the rule would require it to do, and in addition has other alternatives, hence "surely," it is said, it can do better than the rule. An alternative version of the same argument applies it to the legislature. If the legislature is willing to adopt the rule, it is said, surely it will also be willing to legislate the "right" policy in each specific case. How then, it is said, does the adoption of the rule provide any protection against irresponsible political action?

The same argument could apply with only minor verbal changes to the first amendment to the Constitution and, equally, to the entire Bill of Rights. Is it not absurd, one might say, to have a standard proscription of interference with free speech?

Why not take up each case separately and treat it on its own merits? Is this not the counterpart to the usual argument in monetary policy that it is undesirable to bind the hands of the monetary authority in advance; that it should be left free to treat each case on its merits as it comes up? Why is not the argument equally valid for speech? One man wants to stand up on a street corner and advocate birth control; another, communism; a third, vegetarianism, and so on, *ad infinitum*. Why not enact a law affirming or denying to each the right to spread his particular views? Or, alternatively, why not give the power to decide the issue to an administrative agency? It is immediately clear that if we were to take each case up as it came, a majority would almost surely vote to deny free speech in most cases and perhaps even in every case taken separately. A vote on whether Mr. X should spread birth control propaganda would almost surely yield a majority saying no; and so would one on communism. The vegetarian might perhaps get by though even that is by no means a foregone conclusion.

But now suppose all these cases were grouped together in one bundle, and the populace at large were asked to vote for them as a whole; to vote whether free speech should be denied in all cases or permitted in all alike. It is perfectly conceivable, and I would say, highly probable, that an overwhelming majority would vote for free speech; that, acting on the bundle as a whole, the people would vote exactly the opposite to the way they would have voted on each case separately. Why? One reason is that each person feels much more strongly about being deprived of his right to free speech when he is in a minority than he feels about depriving somebody else of the right to free speech when he is in the majority. In consequence, when he votes on the bundle as a whole, he gives much more weight to the infrequent denial of free speech to himself when he is in the minority than to the frequent denial of free speech to others.

Another reason, and one that is more directly relevant to monetary policy, is that if the bundle is viewed as a whole, it becomes clear that the policy followed has cumulative effects that tend neither to be recognized nor taken into account when

each case is voted on separately. When a vote is taken on whether Mr. Jones can speak on the corner, it cannot allow for the favorable effects of an announced general policy of free speech. It cannot allow for the fact that a society in which people are not free to speak on the corner without special legislation will be a society in which the development of new ideas, experimentation, change, and the like will all be hampered in a great variety of ways that are obvious to all, thanks to our good fortune of having lived in a society which did adopt the self-denying ordinance of not considering each case of speech separately.

Exactly the same considerations apply in the monetary area. If each case is considered on its merits, the wrong decision is likely to be made in a large fraction of cases because the decision-makers are examining only a limited area and not taking into account the cumulative consequences of the policy as a whole. On the other hand, if a general rule is adopted for a group of cases as a bundle, the existence of that rule has favorable effects on people's attitudes and beliefs and expectations that would not follow even from the discretionary adoption of precisely the same policy on a series of separate occasions.

If a rule is to be legislated, what rule should it be? The rule that has most frequently been suggested by people of a generally liberal persuasion is a price level rule; namely, a legislative directive to the monetary authorities that they maintain a stable price level. I think this is the wrong kind of a rule. It is the wrong kind of a rule because it is in terms of objectives that the monetary authorities do not have the clear and direct power to achieve by their own actions. It consequently raises the problem of dispersing responsibilities and leaving the authorities too much leeway. There is unquestionably a close connection between monetary actions and the price level. But the connection is not so close, so invariable, or so direct that the objective of achieving a stable price level is an appropriate guide to the day-to-day activities of the authorities.

The issue what rule to adopt is one that I have considered at some length elsewhere.[3] Accordingly, I will limit myself here

[3] *A Program for Monetary Stability*, *op. cit.*, pp. 77–99.

to stating my conclusion. In the present state of our knowledge, it seems to me desirable to state the rule in terms of the behavior of the stock of money. My choice at the moment would be a legislated rule instructing the monetary authority to achieve a specified rate of growth in the stock of money. For this purpose, I would define the stock of money as including currency outside commercial banks plus all deposits of commercial banks. I would specify that the Reserve System shall see to it that the total stock of money so defined rises month by month, and indeed, so far as possible, day by day, at an annual rate of X per cent, where X is some number between 3 and 5. The precise definition of money adopted, or the precise rate of growth chosen, makes far less difference than the definite choice of a particular definition and a particular rate of growth.

As matters now stand, while this rule would drastically curtail the discretionary power of the monetary authorities, it would still leave an undesirable amount of discretion in the hands of Federal Reserve and Treasury authorities with respect to how to achieve the specified rate of growth in the money stock, debt management, banking supervision, and the like. Further banking and fiscal reforms, which I have spelled out in detail elsewhere, are both feasible and desirable. They would have the effect of eliminating present governmental intervention into lending and investing activity and of converting governmental financing operations from a perpetual source of instability and uncertainty into a reasonably regular and predictable activity. But, though important, these further reforms are far less basic than the adoption of a rule to limit the discretion of the monetary authorities with respect to the stock of money.

I should like to emphasize that I do not regard my particular proposal as a be-all and end-all of monetary management, as a rule which is somehow to be written in tablets of stone and enshrined for all future time. It seems to me to be the rule that offers the greatest promise of achieving a reasonable degree of monetary stability in the light of our present knowledge. I would hope that as we operated with it, as we learned

more about monetary matters, we might be able to devise still better rules, which would achieve still better results. Such a rule seems to me the only feasible device currently available for converting monetary policy into a pillar of a free society rather than a threat to its foundations.