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DISSOLVING "THE UNHOLY MARRIAGE": HAYEK'S RECOMMENDATION ON MONETARY AND FISCAL POLICY

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Abstract

The contribution by the Austrian economist Friedrich von Hayek to monetary theory stimulates a far-reaching debate on the role of the government in monetary management and the effects of alternative policies in regulating the issuance of money. Since the early 1930s Hayek had been concerned about the role of money in the theory of production (Hayek, 1931). Influenced by Eugene Bohm-Bawerk's theory of capital, Hayek deeply examined the effects of monetary policy on the process of capital accumulation. As regards investment decisions, Hayek considered that an inflationary credit expansion by the central bank can lead to capital misallocation over time caused by artificially low interest rates.

Indeed, the fundamental problem in economics, for Hayek, is that of coordinating the plans of many independent individuals.The main advantage of a competitive economic order, in Hayek's view, is that rational agents respond to price signals, which convey the relevant information available in the markets, for the purpose of economic calculus. In his view, competition, through the price market system, leads to such coordination. The underlying critique relies on arbitrary interventions related to the presence of the state in economic systems (see, for example, Hayek, 1944). After the Second World War, Hayek discussed the redefinition of the legitimacy of the state and stressed the need to defeat the growing state intrusion in a democratic framework. Besides, he privileged the analysis of the values that shape the interrelations of individuals in a free society. Assessing the practical superiority of the free market dynamics over governments' actions, Hayek believed that no government can know enough to effectively plan the future path of the economy and society. Further, central banks do not have the relevant information to correctly manage the money supply.

Frederic von Hayek, in fact, restated the relevance of concepts and ideas proposed by the classical liberal philosophy so as to rebuild the foundations

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of constitutional governments to face the institutional decay in contemporary societies. As a result, in the 1970s, Hayek proposed the abolition of the government's monopoly over the issue of fiat money to prevent price instability (Hayek, 1976). His defense of a complete privatization of money supply stemmed from his disappointment with central banks' management, which, in his opinion, had been highly influenced by politics. He warned that political interference over monetary policy and price stability is incompatible with social cohesion. At that time, Hayek's proposal of institutional reform relied on denationalization of money in the framework of a free market monetary regime where only those currencies that have a stable purchasing power would survive.

In Hayek's contribution to monetary policy, although employment and price stability are not necessarily in conflict, priority should be given to monetary stability. Aware of the price stability challenges, Hayek strongly highlighted the dangers that arise from monetary financing public spending. Considering this background, our aim is to rethink the theoretical foundations of Hayek's recommendation for the dissolution of "the unholy marriage" (Hayek, 1976, p. 117) between monetary and fiscal policy, which, in his opinion, had formally consecrated the victory of "Keynesian" economics after the Second World War.

Keywords: *economic order, competition, money, economic and political freedom*

JEL Classification: *E12, E52, E62*

Introduction

The contribution by the Austrian economist Friedrich von Hayek to monetary theory stimulates a far-reaching debate on the role of the government in monetary management and the effects of alternative policies in regulating the issuance of money. [2] In his opinion, the fundamental problem in economics is that of coordinating the plans of many independent individuals. The underlying critique relies on arbitrary interventions related to the presence of the state in economic systems (Hayek, 1944). Assessing the practical superiority of the market, he restated the relevance of concepts and ideas proposed by the classical liberal philosophy so as to rebuild the foundations of constitutional governments that could face the institutional decay in capitalist contemporary societies.

2 In 1931 Hayek became Professor of Economics at the London School of Economics. His powerful polemic against socialism, *The Road to Serfdom,* published in 1944, made him both famous and notorious. In 1959, Hayek moved to the University of Chicago where he was Professor of the History of Thought. After returning to Europe in 1961, he was Professor of Economics at the Universities of Freiburg and Salzburg, until he retired in 1973. See www.montpelerin.org/montpelerin/mpsHayek.html

Hayek highlighted the analysis of the conditions of economic stability: the stable business conditions and the stable value of money. Considering this background, our aim is to rethink the theoretical foundations of Hayek's recommendation for the dissolution of "the *unholy marriage"* (Hayek, 1976, p.117) between monetary and fiscal policy, which, in his opinion, had formally consecrated the victory of "Keynesian" economics after the Second World War. Section one presents the foundations of the concept of economic order and addresses his view about the economic process and the role of the government in modern societies. Section two presents his critique to the Keynesian policy agenda. Section three rethinks the theoretical foundations of the stable value of money and the interconnections between Hayek's economic and political proposals. Finally, the conclusions highlight his attempt to build a neoliberal discourse.

The economic order

Hayek's theoretical contribution was articulated with an ideological political project that endeavors to create a social reality that it suggests already exists. Hayek claimed that his goal was to explain how the economic process works without attempting to explain their results or to predict its course. At this respect, he criticized what he called "prophetic economic discourses" that believe in an eschatological end - such as the discourse of Marx (Hayek, 1995). For the author, the best example of the road to serfdom was the economic path traced by an omnipotent reason that understands society as a rational machine or an economic order that could be built by the deliberation of rational individuals.

The starting point of his microeconomic analysis, an individual that is "inescapable ignorant" and whose limited reason is unable to totally unveil the complexity of the world. As men have an incomplete and fragmented knowledge of the world, the complex phenomenon of the market will never be fully known. However, this ignorant man is aware of his limitations and, through a process of experimentation, he examines the facts and adapts to them for his own purpose. As a result, he selects the rules of behavior that offer solutions to recurring problems (Hayek, 1983). According to the author, this process does not require consensus on the purposes, but it serves a wide variety of purposes. In fact, the Austrian economist criticized the orthodox neoclassical conception of individuals who, as a result of rational choices, produce a stable economic order. Instead, he highlights that men are followers of rules and aware of their limitations facing a complex world that will never be fully unveiled.

Those selected rules are products of the experience of generations and, above all, they can't give an answer to general private purposes. However, they should respect the principle of increasing the opportunity of all. In this process, the role of the government is to ensure the logical foundation of a free society (Hayek, 1937a and 1973). In the economic order, the principle of competition is, *par excellence,* the principle that guides the generation of wealth in an institutional context that preserves individual freedom. Considering the human behavior in the economic order, Hayek developed the idea of a cultural evolution as a process of social learning where the products of civilization are the outcomes of unintentional trials and errors. As society becomes more complex, its survival depends on the selection of rules that reaffirm the primacy of the economic order where market competition is preserved.

As a matter of fact, in the economic order, as a *necessary* one, the principle of competition is a pillar of Hayek's theoretical construction. The competitive market is a required order in which men make choices and the fundamental economic problem is that of coordinating the plans of many independent individuals. The main advantage of the competitive economic order, in Hayek's view, is that rational agents respond to price signals, which convey the relevant information available in the markets, for the purpose of economic calculus. In his view, competition, through the market price system, leads to such an efficient coordination. Individuals, acting in their own self-interest, respond to prices which, in turn, reflect the information available in society for the purpose of economic calculus. Indeed, prices are signals that support an extensive social division of labor in a context of individual freedom.

Without certain institutions and practices, the economic process that brings about the coordination of plans of consumers and producers would not take place. The decision about the allocation of resources is a process that relies on private property incentives, relative prices and profit and loss accounting. However, for Hayek, the problem of coordination is not associated with the problem of equilibrium. Equilibrium, by definition, is a state of affairs in which no agent within the system has any incentive to change. In this state of affairs, the situation would lead individuals to a state of rest where all plans were coordinated and resources were used in the most efficient manner currently known. [3]

Indeed, Hayek's concern did not rely on the state of equilibrium but he underlines the process which tends to bring about equilibrium. In his opinion, the proposition of competitive equilibrium was irrelevant for the world outside of that state of equilibrium. According to the Austrian economist, the theoretical problem that arises when concentrating on a state of equilibrium as opposed

3 Hayek theoretically criticized the socialist program proposed by the Lange conditions. These conditions hold that a) prices would be set to marginal cost -and thus the full opportunity cost of production would be reflected in the price and b) production would be at the minimum point on the firm's average cost curve -and thus the least-cost technologies would be employed.

to the process of change in economic analysis is that the attention is away from how changing market circumstances require adaptations on the part of individuals in the market. For him, economics is a discipline that should pay attention both to change and trends.

His rejection to the mechanistic character of the Walrasian and the neoclassical analysis was founded on the critique of the concept of equilibrium. In the equilibrium of perfect competition, the allocation of resources requires a correspondence between the underlying conditions of tastes, technology and resource endowments (known as underlying variables) and the evolution of prices and profit-loss accounting (the induced variables). In other words, the underlying variables and the induced variables are in perfect alignment and thus there are no coordination problems.[4] Instead of this equilibrium approach, Hayek adopted an evolutionary approach and underlined that economic and social phenomena are not likely to be picked up by methods of knowledge like mathematics.[5] And he argued that, although perfect knowledge is a defining characteristic of equilibrium, it cannot be an assumption out of equilibrium. For him, the relevant question is: *how do individuals come to learn the information that is necessary for them to coordinate their plans with others?*

In his classic articles *Economics and Knowledge* and *The Use of Knowledge in Society,* Hayek inquired how economic agents come to learn in the market process. Within this process, that represents the crucial empirical issue of economics, the price signals represent the key institutional guide post for learning within the market process. In addition to the incentive role of prices taught by the traditional neoclassical theory, Hayek pointed out that prices also serve an informational role. He warned that this role had been overlooked by modern economists only preoccupied with models of equilibrium.

In these two classic articles over his career, Hayek came to place particular emphasis on the contextual nature of knowledge utilized within the economic process since it does not exist disembodied from the context of its discovery and use. As a result, economic participants base their actions on concrete information they learn in particular time and place. Outside of that context, this knowledge is incapable of being used by the government in order to effectively plan the organization of society. Hayek's rejection of planning was not only based on the informational problem. According to the Austrian economist, a competitive environment provides individuals, acting on the basis of selfish

4 However, Hayek sought to explain the lagged relationship between the underlying and the induced variables. Changes in the underlying conditions set in motion accommodating adjustments that are reflected in the induced variables on the market. The induced variables lag behind, but are continually pulled towards the underlying conditions.

5 Hayek believed that the Walrasian model was one of the best expressions of modernity since it assumed, from the philosophical point of view, that the world could be unveiled by the power of reason and the use of a good method. On the relation of reason and method see Descartes (1959).

behavior, with the incentive to be as innovative as possible. The growth of wealth is stimulated, if institutions - as the government-do not interfere with individuals' freedom to take initiative. If governmental planning prevents private action unlimitedly, the result will be general impoverishment, whatever the motives of the government intervention.

In truth, Hayek highlighted the importance of retaining the idea of citizenship at the center of modern political debates and insisted that the welfare state policies were, *per se,* enemies of the classical liberal notion of freedom. Under his view, a capitalist market system of social exchange is primarily justified because it protects individual freedom, that is to say, freedom to life of every human being *as an individual.* This system achieves the complex task of production and distribution through a process of voluntary exchanges where coordination is effectively achieved without coercion. The market, as the economic foundation of capitalism, is recognized as the basis of equality among people. His criticism reaches the so called "rational" interventions of the government, which aims to correct the market failures, since this aim turns out to be contradictory: every intervention of the government, despite the targets, produces injustices and inefficiencies in the context of the order of the market.

The underlying critique relies on arbitrary interventions related of the governments in the economic order (Hayek, 1944). After the Second World War, Hayek discussed the redefinition of the legitimacy of the government and stressed the need to defeat the growing government intrusion in a democratic context._ His point of departure was the institutional decay in modern capitalist societies and the need to rebuild the foundations of economic and political freedom by means of the strengthening of constitutional governments. Taking into account the connection between economic and political freedom, the Austrian economist discussed the challenges to social, economic and political development in a constitutional order. On behalf of the superiority of the economic outcomes of the free competitive order over the arbitrary interventions of the government, Hayek pointed out the need to restrain the power of the governments in the international settlement.

In other words, the underlying critique is the weight of the government and the menace of arbitrary interventions on individuals after the Second World War. In *The Constitution of Liberty* (1960), Hayek built his view on the limits of human cognition to highlight that no government can know enough about a society to plan its future effectively. Indeed, the government's true role is more modest: to create general and equally applied laws that constitute the matrix in which the spontaneous interactions of individuals can occur in the economic order. Hayek's main concern was to show that the reconciliation of individuality and community depends on individual freedom. Indeed, he privileged the analysis of the values that shape the interrelations between individuals in a free society. In this attempt, the concept of common good is a social construction based on values, such as the inviolability of the person, individual freedom and justice. In other words, the economic order is considered to be the best form of organization for contemporary societies and the legitimacy of the government should be based on its limited power.

The unholy marriage

In the context of the Bretton Woods period, his critique to the Keynesian interventions to promote the expansion of the aggregate demand focuses on the error of not respecting the “spontaneous” economic order (Hayek, 1995). Indeed, the axle of Hayek’s contribution to economic policy is the analysis of the relations between individuals and the government in the economic order. As of the 1970s, in *Denationalization of Money- the Argument Refined,* Hayek proposed the abolition of the government’s monopoly over the issue of fiat money in order to prevent price instability. Hayek clearly expressed his discontent with the history of the government management of money- mainly because of the orientation of Keynesian ministers of finance. In particular, he noted that the popularity of ‘Keynesian’ economics was due to the fact that:

> “*... Ministers of finance were told by economists that running a deficit was a meritorious act, and even that, so long as there were unemployed resources, extra government expenditure cost the people nothing, any effective bar to a rapid increase in government expenditure was destroyed.”* (Hayek, 1976: 118)

Hayek strongly emphasized the conflict between the two goals of economic policy: public finance and the regulation of a stable currency. For him, it is highly undesirable in any circumstances that funds for government spending should be provided by the creation of additional money. And he emphatically warned:

> *“If we are to preserve a functioning market economy (and with it individual freedom), nothing can be more urgent than that we dissolve the unholy marriage between monetary and fiscal policy, long clandestine but formally consecrated with the victory of’Keynesian’ economics*.” (Hayek, 1976: 117)

Hayek highlighted that, on behalf of the g*overnment monopoly of money,* central banks accommodate the financial ‘needs’ of government by keeping interest rates low and, as a result central banks give their policies an inflationist bias. However, in his view, the use of money supply as an instrument for achieving particular ends turns out to destroy the equilibrating operation of the price mechanism and provoke major business fluctuations in a context of "unlimited democracy" in which government has the power to confer special material benefits on groups (Hayek, 1976: 119).

At this respect, Hayek's underlying critique of Keynesian economics relies on the arbitrary interventions of the governments in the economic order (see, for example, *The Road to Serfdom)* since he underlined the difficulty of restraining a bureaucratic apparatus not controlled by profit and loss calculations. At this respect, Hayek noted that the process of budgetary monetary financing is a self-accelerating process since this style of finance (the Keynesian style) turns out to create new expectations of further bounty. In Hayek's words: *"..One (process) which even men who genuinely wish to avoid it find it impossible to stop'* (Hayek, 1976: 119).

The axle of the Austrian economist Friedrich Hayek's monetary theory contribution stimulates further discussion about the role of money and the challenges for the stability of the value of money. As a matter of fact, in the 1930a and 1940s, Hayek searched for systematic elaboration of the Austrian theories of capital, money, business cycles and comparative monetary institutions. One definite contribution of his theory of capital and money is the emphasis on the study of the effects of monetary changes in relative prices of commodities in the context of industrial fluctuations.

In truth, since the early 1930s, Hayek's *Prices and Production* was concerned about the theory of production in which the existence of money leaves production and the relative prices of goods undisturbed as money is usually defined as the generally accepted medium of exchange. And he added that a generally accepted medium of exchange will generally acquire also other functions, such as, unit of account, store of value and a standard of deferred payment etc. (Hayek, 1976:55).

Influenced by Eugene Bohm-Bawerk's theory of capital, Hayek deeply examined the effects of monetary policy on the process of capital accumulation. In his monetary approach, the explanation of the causes which make investment more or less attractive can only be reached by closely analyzing the microeconomic factors determining the relative prices of capital goods in the different stages of production. Changes in the relation between saving and investment not only affect the money-streams and purchases of consumers and entrepreneurs but also influence the relative prices and the structure of production. So as to expand the productive capacity, entrepreneurs can use borrowed money to purchase capital goods if money is obtainable at a rate of interest lower than the rate of yield on existing capital. This process will continue until the price of capital goods is so increased that the rate of yield is lowered to equal the rate of interest. Considering investment decisions, Hayek assessed that the central bank's inflationary credit expansion business cycles can lead to capital misallocation over time caused by artificially low interest rates.

As of the 1960s and 1970s, his theoretical critique relied on the false Keynesian foundations of economic stability. Indeed, Hayek condemned the Keynesian argument that government deficits are necessary to reduce unemployment. Under his view, although employment and price stability are not necessarily in conflict, priority should be given to monetary stability. A stable price level is, in principle, of central importance in ensuring that the three famous microeconomic functions which money provides are allowed to operate with maximum efficiency. Aware of the price stability challenges, he strongly highlighted the dangers that arise from monetary financing public spending in order to cure unemployment. In other words, the Austrian economist did not believe that the anti-cyclical government spending could mitigate any slackening of economic activity. Instead, in his opinion, what the Keynesian policy produces is a distribution of employment which can only be maintained for some time by a rate of inflation which would rapidly lead to a disorganization of all economic activity. As a matter of fact, Hayek focused his attention on the role of the injections of amounts of money in the structure of relative prices and the consequent misallocation of resources and, particularly, the misdirection of investments which it causes. In this perspective, all inflation is called 'demand-pull' inflation.

In his 1974 Nobel Prize speech, *The Pretense of Knowledge,* Hayek argued that the Keynesian recommendations to cure unemployment turns out to create patterns of resource employment that cannot be maintained without price instability and the disorganization of the economic activity. He emphatically condemned the mistakes of Keynesian policies. In his own words:

> *"The continuous injection of additional amounts of money at points of the economic system where it creates a temporary demand which must cease when the increase of the quantity of money stops or slows down, together with the expectation of a continuing rise of prices, draws labor and other resources into employments which can last only so long as the increase of the quantity of money continues at the same rate - or perhaps even only so long as it continues to accelerate at a given rate. What this policy has produced is not so much a level of employment that could not have been brought about in other ways, as a distribution of employment which cannot be indefinitely maintained and which after*

> *some time can be maintained only by a rate of inflation which would rapidly lead to a disorganization of all economic activity. The fact is that by a mistaken theoretical view we have been led into a precarious position in which we cannot prevent substantial unemployment from reappearing; not because, as this view is sometimes misrepresented, this unemployment is deliberately brought about as a means to combat inflation, but because it is now bound to occur as a deeply regrettable but inescapable consequence of the mistaken policies of the past as soon as inflation ceases to accelerate... "*

In truth, Hayek was one of the strongest critics of this Keynesian transformation of the discipline of economics. As of the 1970s, he condemned the role of the economists in promoting the engineering of social change through macroeconomic modeling. Under his view, for the Keynesian income expenditure model to work, the economist must know the aggregate level of current consumption, investment, and public spending, as well as the full employment level of output and the multiplier effect. As each step of the analysis presupposes that the detailed knowledge of economic life is available and that the outcomes of each policy intervention will be precise effects on economic activity, he believed that the Keynesian macroeconomic policy was mistaken.

In the case of such a complex phenomenon as the market, Hayek believed that neither macroeconomics nor microeconomics, although alternative methods of dealing with the market, gather all the factual information that is required to provide a full explanation of the economic phenomena. Under his view, macroeconomics attempts, such as the Keynesian attempt, by reference to aggregates or averages statistically available, give an unsatisfactory and sometimes misleading theoretical explanation of causal connections since this explanation asserts empirically observed correlations with no justification for the belief that they will always occur. Alternatively, the microeconomics approach - which he prefers- relies on the construction of models which cope with the problem by diminishing the number of independent variables *"to the minimum required to form a structure which is capable of producing all the kinds of movements or changes of which a market system is capable"* (Hayek, 1976:80).

Money in a free society

As of the 1970s, the Austrian economist pointed out that political interference over monetary policy and the maintenance of price stability are inherently incompatible to preserve economic freedom. He not only apprehended the nature of the overall transformations in capitalist societies after the Second

World War but he also identified the contemporary threats to individual freedom. In fact, he restated the relevance of concepts and ideas proposed by the classical liberal philosophy in order to rebuild the foundations of constitutional governments so as to face the institutional decay in contemporary societies. Expressing concerns about the fragile contemporary institutional set up where the actions of central banks could have deep effects on individual freedom and social cohesion, Hayek points out the need to think about the institutional dimensions of society and the role of the economist in economic and social change.

Assessing the practical superiority of the free market dynamics over governments' discretionary interventions, Hayek believed that no government can know enough to effectively plan the future path of the economy and society. Moreover, central banks do not have the relevant information to correctly manage the money supply. As a result, central banks have disturbed the competitive mechanism of the market. His concern about the tendency of unlimited governments to grow indefinitely relies on the treat to the future of capitalist civilization. Hayek increasingly focused on the badness of the money supplied by governments to grant special benefits to particular interests. Considering the abuse of power, he suggested to deprive not only the government monopoly of issuing fiat money but also the government power of making any money 'legal tender' for all existing debts. Hayek's advocated the complete privatization of money supply, as revealed by the views expressed in *The Constitution of Liberty,* in the 1960s, and those views presented in *Denationalization of Money,* as of the 1970s.

In fact, his defense of a complete privatization of money supply stemmed from his disappointment with central banks' management, which, in his opinion, had been highly influenced by politics. In his view, despite the damages caused by inflation, the adoption of partial remedies for some of the symptoms, such as unemployment, would probably prolong and increase the inflationary process. The most conspicuous effect is on the whole structure of relative prices since its distortion provokes the misdirection of resources and factors of production (especially the investment of capital) into uses which remain profitable only so long as inflation accelerates. In the long run, the "Keynesian" attempts to accept wage and price rigidities as inevitable and to adjust monetary policy to them make the whole wage structure more rigid and, as a consequence, lead to the destruction of the market economy.

Hayek believed that economists do not have to play the role of political leaders or groups but they must continue to point out that to persist in this direction will lead to disaster since the political interference over monetary policy and price stability is incompatible with social cohesion. At that time, Hayek's proposal of institutional reform relied on a denationalization of money in the framework of a free market monetary regime where only those currencies that have a stable purchasing power would survive. His proposal of an institutional reform of the denationalisation of money would be achieved by the complete abolition of the government monopoly over the issue of fiat money. This proposal would leave the way open for a comprehensive privatization of the supply of money.

The ultimate objective of the denationalization of money advocated by Hayek was related to monetary policy independence from political interference. The basic idea is that the possibility of banks issuing different currencies would open the way to market competition. Banks could issue non-interest bearing certificates and deposit accounts on the basis of their own distinct registered trade mark and the currencies of different banks would be traded at variable exchange rates.

In *Denationalization of Money,* Hayek underlines that the main advantage of the economic order is that prices will convey to the acting individuals the relevant information to make decisions to adjust their activities in face of the competition of currencies. Hayek underlined that there are four kinds of uses of money that would chiefly affect the choice among available kinds of currency: i) for cash purchases of commodities and services, ii) for holding reserves for future needs; iii) in contracts for deferred payments, and iv) as a unit of account, especially in keeping books. He was critical of the mistaken of thinking of different ‘functions’ of money instead of ‘uses’. In his opinion, these uses are, in effect, consequences of the basic function of money as a medium of exchange. Only in exceptional conditions, such as rapid depreciation of the medium of exchange, these uses - otherwise interdependent- come to be separated from the function of money as a medium of exchange. Under these conditions, the stability of the value money as a unit of account is the most desirable of all the uses (Hayek, 1976: 67).

Competition and profit maximization would lead to market equilibrium where only the banks that pay a competitive return on liabilities to their clients could survive. Since currency corresponds to non-interest-bearing certificates, the crucial requirement is the maintenance of the value of the currency. Under Hayek’s theoretical framework, the market forces would determine the relative values of the different competing currencies. In other words, the exchange rates between the competing currencies would float freely. So, in equilibrium, only currencies guaranteeing a stable purchasing power would exist. People would not want to hold on to the currency of an issuer that was expected to depreciate relative to one that was expected to hold its value in terms of purchasing power over goods and services. The marginal costs of producing and issuing a currency (notes and coin) are rather low (close to zero) and the nominal rate of interest would be driven (close) to zero. Banks that failed to build up stability for the value of their currencies would lose customers and be driven out of financial business.

Therefore, in the long run, a successful choice between alternative currencies for use in production and trade depend on the stability of the value of the currency in terms of commodities.[6] Aware that some prices always change on a free market, in *Denationalsation of Money,* Hayek proposed the idea of setting a standard set of wholesale prices of commodities to be treated as the standard of value in which people would prefer to have their currencies kept constant. As a result, currencies whose value was based chiefly on commodities important for particular occupations and habits, or for one group of predominant industries, might fluctuate relatively more against others (Hayek, 1976:76). In other words, the decisive factor that would create a general preference for a value stable in terms of commodities since this feature would make realistic economic calculation possible effective - or even, would make capital and cost accounting possible.

Despite the rejection of Friedman’s monetary rule, Hayek said he was in complete agreement with Friedman on the inevitability of inflation under the existing political and financial institutions. For Hayek, money is not a tool of policy that can achieve particular foreseeable results by control of its quantity. Indeed, Hayek rejects Professor Friedman’s proposal of a legal limit on the rate at which the central bank- as the monopolistic issuer of money - was to be allowed to increase the quantity in circulation in order to maintain price stability. The Austrian economist underlined that a stable price level and a high and stable level of employment neither require a constant total quantity of money nor changes of the total quantity of money at a constant rate. Indeed, only the market can discover this ‘optimal quantity of money’ that can be provided only “by *selling and buying at a fixed price the collection of commodities the aggregate price of which we wish to keep stable”* (Hayek, 1976:81).

In short, Hayek underlined that, without radical changes in the political and institutional framework, the inflationary process will lead to the destruction of the capitalist civilization. Indeed, his proposal concerning money is part of a much more far-reaching reform agenda. He proposed two distinct although complementary reforms in the economic and the political order: the proposal on the monetary system may be possible only under a limited government and a limitation of government may require the end of its monopoly of issuing money.

6 Aware that some prices always change on a free market, in *Denationalisation of Money,* Hayek proposed the idea of setting a standard set of wholesale prices of commodities to be treated as the standard of value in which people would prefer to have their currencies kept constant. As a result, currencies whose value was based chiefly on commodities important for particular occupations and habits, or for one group of predominant industries, might fluctuate relatively more against others (Hayek, 1976:76).

Conclusion

As Kukathas recalls, Hayek started his intellectual life as an economist but turned his attention to political philosophy late in his career (Kukathas, 2012). Through his life, his thought developed in a more libertarian direction. Indeed, he defended a philosophy of liberalism as an antidote to the development of totalitarian regimes. Although he retained some role for the government, he became more skeptical about the role of the government in the provision of public goods because the political process was infected by particular interests.

In the last decades, the emergence of the neoliberal agenda reflected the intellectual victory of Hayek's ideas about the supremacy of the competitive economic order, the critique to the interventionism of the governments to promote economic growth and the relevance of price stability.

Indeed, we can say that Hayek turned out to build a discourse on liberalism. If we follow the interpretation of Foucault (2010) on the foundations of the economic discourse, Hayek's theoretical efforts were designed to show, as the result of the outcomes of the Bretton Woods period, that the challenges to capitalist society could be overcome by political and institutional "reforms". Hayek replaced the conception of the economy as a domain of autonomous rules and laws by a concept of "economic order" where the principles of competition and of the stable value of money are underlined. As a result, monopolization is not some economic destiny, but the result of failed political strategies and inadequate forms of institutionalization. At this respect, the government monopoly power of issuing money is also condemned. The question he faced was how governments could act on the basis of economic freedom since the freedom of individuals in competitive markets produces the legitimacy for a form of sovereignty that is limited to support economic activity.

Besides, Hayek highlighted that it is not capitalism which is responsible for the emergence of social problems. Instead he noted that these problems are the product of planning methods and growing bureaucratic apparatuses deployed, after the Second World War, by the "enemies" of the market mechanism. In Hayek's view, the government and the market economy are not juxtaposed to each other but that the one mutually presumes the existence of the other (Foucault, 2010).

Under his understanding of the economic process, the unemployment and inflation challenges were not compellingly innate to the logic of capitalism but of a contingent historical nature. For Hayek, the history of capitalism is an economic-institutional history. For this reason, he built the understanding of the economic process in institutional terms. Under such conditions, he rejected the existence of an autonomous domain of the economy with its own rules and limits. In his approach, the domain of liberty (the market) presupposes the legitimate domain of government intervention. Thus, the economic process and its institutional set up are not only articulated but also refer to and support each other. Indeed, the political dimension of this articulation addresses the survival of the “capitalist civilization”.

In other words, Hayek assumed that the survival of the capitalist system depends on political innovations. In his neoliberal discourse, there is nothing wrong with the “logic of capitalism” but with its institutions that are opened to political changes.

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