

---

# Malignant Monetary Monocentricity

— ◆ —

ALEXANDER WILLIAM SALTER

## Monetary Institutions: Monocentric versus Polycentric

**T**he monetary authority of the United States, the Federal Reserve, is widely perceived to be independent of politics. Founded with the relatively limited intention of formalizing the interbank clearing system, it would soon morph into a true central bank, acquiring additional protections from political interference over time (Hetzl and Leech 2001; Bernanke 2010; Bordo and Prescott 2019). Perhaps the most noteworthy event is the Fed–Treasury Accord of 1951, inaugurating a formal separation of the monetary authority from the fiscal authority. Today, the Fed is regarded as an apolitical and prudent steward of the macroeconomy with a wide range of duties, from maintaining macroeconomic stability during ordinary times (e.g., standard open-market operations) to combating financial panic during extraordinary times (e.g., its response to the 2007–8 crisis). The combination of institutionalized apoliticism and expert governance—monetary policy makers are typically drawn from elite circles in law, finance, and academic macroeconomics—is important for the Fed’s prestige.

Undoubtedly those at the helm of the Fed are impeccably trained. But the popular view of the Fed as insulated from politics is simply mistaken. The Fed always has been

---

Alexander William Salter is assistant professor of economics in the Rawls College of Business at Texas Tech University.

*The Independent Review*, v. 25, n. 2, Fall 2020, ISSN 1086–1653, Copyright © 2020, pp. 249–264.

and always will be a creature of politics (Boettke and Smith 2013, 2015). President Lyndon Johnson famously called his Fed chairman, William McChesney Martin, down to his ranch to browbeat him. The pressure President Richard Nixon placed on Arthur Burns for accommodative monetary policy is well known. President George H. W. Bush's salvos against the Fed were so frequent and irritating as to damage Fed–Treasury relations. And most recently, President Donald Trump joined this august club of presidential monetary meddlers, albeit in a less-dignified fashion. Writing in the *Wall Street Journal*, Alan Blinder, a highly accomplished academic economist and former Fed vice chair, commented on how

Mr. Trump began his war on the Fed with a barrage of verbal abuse—berating the central bank, and [Fed chairman] Mr. Powell in particular, as “going loco” and being “the only problem our economy has.” He made it clear that he regretted appointing Mr. Powell as chairman. But as my mother taught me when I was a kid, “Sticks and stones can break your bones, but words can never hurt you.”

So Mr. Trump turned to sticks and stones. First, he threatened to fire Mr. Powell, which he plainly lacks the authority to do. Then he threatened to demote Mr. Powell to being an ordinary member of the Federal Reserve Board (his previous position), not chairman. That, too, is almost certainly illegal. (2019)

President Trump certainly abjures playing by Marquess of Queensberry rules, to put it mildly. Twitter is among his favorite media for expressing outrage. One such tweet, from June 2019, reads (in part): “The Fed Interest rate way too high, added to ridiculous quantitative tightening! They don’t have a clue!” Again, although these remarks are unique in their manner of expression, elected officials—especially presidents—trying to pressure monetary policy makers is nothing new and in fact has been an informal feature of national politics for decades. However, the response to this pressure from the class of financial elites and macroeconomic philosopher-kings in the Fed *has* been unprecedented. In answer to President Trump’s behavior, former New York Fed president William Dudley published an article in *Bloomberg* that comes dangerously close to suggesting the Fed should use its power to influence the 2020 election. Because “Trump’s reelection arguably presents a threat to the U.S. and global economy, to the Fed’s independence and its ability to achieve its employment and inflation objectives,” Dudley wrote, the Fed ought to “consider how their [*sic*] decisions will affect the political outcome in 2020” (2019). Apparently political pressure is a double-edged sword!

This situation is obviously concerning to those who care about macroeconomic stability and the rule of law. Political feuds between the White House and the Fed have the potential to spill over into other areas, causing both economic and political—especially constitutional—damage to the American republic. While President Trump’s

uniquely bellicose personality is surely part of the explanation for this newest stage in the conflict, there is a deeper, institutional aspect to it as well. The Fed has more power than it ever held before; therefore, being able to influence its behavior, whether formally or informally, has become more important. The Fed acquired an array of new monetary, financial, and regulatory powers as a result of the 2007–8 crisis. More than a decade after that crisis, it still has not normalized its balance sheet. The Fed has seemingly shifted to a new monetary policy framework, away from the “corridor” system in which it affected interest rates by participating within the market for loanable funds and to a new “floor” system that uses its ability to pay interest on excess reserves and thus allows it to treat interest rates like policy levers (Mueller and Wojnilower 2016; Beckworth 2018; Plosser 2018; Selgin 2018; Jordan and Luther 2019). And spurred in part by the new literature on “macroprudential” policy (Bernanke 2011; Hanson, Kashyap, and Stein 2011; Lim et al. 2011; Galati and Moessner 2013), the Fed is exercising ever-greater control over the financial system, without any meaningful increase in accountability.

This should make us cautious when discussing the seemingly rosy performance of the U.S. economy since the 2007–8 crisis. A slow recovery eventually gave way to what appears to be economic health: record low unemployment, minimal inflation, and booming financial markets.<sup>1</sup> But this apparent vigor is a facade. Because the Fed has transitioned from a precrisis regime of ordinary monetary policy (traditional open-market operations) to extraordinary monetary policy (the floor system in conjunction with credit allocation), we cannot rely on the typical macroeconomic indicators to give reliable information regarding the strength of the economy. Because the monetary-institutional regime has changed, what we can justifiably interpret from economic data has changed as well (Goodhart 1975; Lucas 1976). Given the massive expansion in the Fed’s balance sheet, combined with the interest-on-excess-reserves policy, we should not be surprised at the resulting “paper boom”!

The nature of Fed control over the U.S. economy is *monocentric* (Salter and Tarko 2017, 373), by which I mean it is consolidated, unitary, and hierarchical. Institutions of this kind are subject to several governance problems. First, as nonmarket entities cut off from the epistemic benefits of the market process (see Hayek 1948; Mises 1949), they have a difficult time acquiring the information they need to fulfill their mandate, which in the case of the Fed is full employment and price stability. Second, due to the lack of accountability mechanisms mentioned earlier, such institutions do not always confront the right incentives to serve the public as they ostensibly should. Because of these problems, it can be argued that not only is the Fed failing to live up to its mandate, but it is also becoming a positive danger, both to economic vigor and to democratic self-governance.

Call the political-economic malaise the Fed has created *malignant monetary monocentricity*. How can it be cured? The surest way is with a complete institutional overhaul. In order to eliminate the malignancy, we must eliminate the monocentricity.

---

1. This passage was written before COVID-19 and the ensuing economic fallout.

In its place should be a monetary system that is *polycentric*: fragmented, overlapping, and concurrent (V. Ostrom, Tiebout, and Warren 1961; E. Ostrom 2010; Aligica and Tarko 2014; Aligica, Boettke, and Tarko 2019; for monetary polycentricity specifically, see Salter and Tarko 2017, 2019). Unlike monocentric systems, polycentric systems institutionalize a partly cooperative, partly competitive architecture that generates information and aligns incentives. Because of this architecture, they are able to meet governance challenges that monocentric systems cannot. And because they disperse decision-making authority more widely, they are compatible with a social ethos of democratic self-governance as well.

I organize the remainder of this paper as follows. In the first section, I expand on the information and incentive problems that all but guarantee monetary monocentricity will be malignant. In the second section, I outline the features of a healthy monetary system governed in polycentric fashion. In the third section, I broaden the analysis beyond economics, showing why monetary polycentricity is important on democratic grounds. And in the fourth section, I conclude by arguing that monetary monocentricity, as a failure of both theory and practice, ought to be decisively and permanently rejected.

## Monetary Monocentricity: Symptoms of the Disease

Malignant monetary monocentricity entails insuperable information and incentive problems. These problems are the reasons for monetary monocentricity's malignancy. Because of the consolidated, unitary, and hierarchical nature of our monetary system, it is incapable of governing the economic system in a way that is both macroeconomically effective and democratically fair, an incapability that entails serious negative consequences for society at large.

Let us begin with information problems. F. A. Hayek (1948) identified the essence of this problem. The knowledge necessary to bring about widespread economic coordination is dispersed throughout society and does not exist in a manner that renders it useable by a single entity. Furthermore, much of this knowledge is tacit and local; it is not objectively communicable in any meaningful sense but is relevant to economic decision making nonetheless. How do economic actors in a market economy cope with this situation? The answer is the market price system, with its underpinnings of private property, contract enforcement, and the rule of law. Economic actors bring their plans and actions into alignment, given the fragmented nature of the requisite knowledge, by using relative prices as a guide. Practicing monetary policy makers often recognize Hayek's fundamental insight. For example, Fed vice chair for supervision Randall Quarles (2019) recently gave a speech that lauded Hayek's contributions to economics. But as Quarles's remarks demonstrate, monetary policy makers have failed to appreciate the radical challenge a Hayekian perspective really poses for command-and-control monetary policy implementation and for central banking more generally.

The purpose of monetary policy is to ameliorate the problems created for the economic system by widespread indirect (monetary) exchange. As Leland Yeager

(1997) recognized, the use of money is not only massively beneficial for society but also potentially costly. The benefits stem from money helping to solve the “double coincidence of wants problem” and thus to economize significantly on transaction costs. But because all goods are priced in terms of money—this follows from the nature of money as the economy’s most saleable good—it is difficult for the *market for money itself* to reach a market-clearing price that brings quantities supplied and demanded into alignment. This can be done, but only by many relative price adjustments throughout the economy because the price of money is simply the inverse of the money-price of goods for the various things consumers regularly purchase. This “monetary disequilibrium” perspective suggests a clear goal for the monetary authority: serve as a referee for the economic system by keeping the market for money balances as close to equilibrium as possible. Because it is only when the money market is in equilibrium that the price system can perform its supremely important function, this task is crucial.

Here is where the knowledge problem becomes pertinent. Can central banks contribute to perpetual monetary equilibrium or at least to a tendency in that direction? It seems clear they cannot (Salter and Smith 2017). Central banks are nonmarket hierarchies. They also have a monopoly on the creation of narrow (base) money and thus serve as the ultimate locus for the stance of monetary policy. These combined features have grave implications for central banks’ epistemic underpinnings as well as broader economic effects. Central banks have cut themselves off from the knowledge-generating properties of the market process (Mises 1949). Because they are not in any meaningful sense subject to profit-and-loss constraints, they cannot make use of standard accounting practices to help them steer policy in the direction of monetary equilibrium (Selgin 1988). Thus, there is no *feedback mechanism* to help central banks approximate their goal. Central banks are forced to rely on, as a second-best option, complicated economic models, calibrated with statistical aggregates, to serve as an epistemic crutch when conducting monetary policy (see Rothbard 1960). But these statistics are a highly imperfect substitute for the knowledge that comes from being embedded with the market process. The most important piece of information for monetary policy makers to know is the public’s money-demand function. As the demand to hold money (as opposed to other assets) rises, in order to prevent deleterious macroeconomic consequences and to maintain monetary equilibrium central banks should accommodate the increase in money demand with an increase in supply. But central banks are at best a step behind the market, which is constantly generating and adapting to endogenously created knowledge. Even if central banks could get a real-time perspective on the public’s money-demand function, there are strategic reasons why this perspective would not be of much use to them in implementing monetary policy. Once private economic actors become aware that the monetary authority is able to predict their behavior for the purposes of control, those actors would have an incentive to change their behavior, thus rendering the relationship between the levers of monetary policy and macroeconomic outcomes unexploitable for policy purposes (Goodhart 1975; Lucas 1976).

A Hayekian perspective on economics and knowledge shows that monetary policy makers simply cannot have at their disposal the knowledge necessary to carry out their mandate. The problems they confront are akin to those experienced by economic central planners. Indeed, because money is one-half of all exchanges, attempts to engineer macroeconomic equilibrium from the top down are rightly viewed as a form of central planning, with all its attendant problems. Thus, monetary monocentricity undermines its own mandate.

But knowledge problems are not the only ones that contribute to the malignancy of monetary monocentricity. Categorically distinct yet equally important are incentive problems. These problems also stem from central banks' status as nonmarket hierarchies with a monopoly on a range of macroeconomically important activities. As bureaucrats, those who staff central banks are institutionally prone to expand their mandate, budget, and prestige (see Niskanen 1968; Tullock 2005). This is not because central bankers are secret Machiavellians. On average, they are probably no different than market actors, such as their counterparts in private banking and finance. But because central banking occurs in myriad political contexts, and because central bankers are not residual claimants to the effects of their activities, the institutional environment within which they operate promotes behavior that is beneficial to the monetary authority but not necessarily to the society that the monetary authority is chartered to serve.

Perhaps the most obvious evidence of incentive problems in central banking is that once prominent academic economists transitioned to becoming central bankers, they publicly changed the beliefs they expounded about monetary policy, often taking actions that conflicted with their own academic work prior to entering the policy world (Salter and Smith 2019). When Arthur Burns became Fed chairman, his former student Milton Friedman was optimistic that Burns, who in Friedman's experience was a proponent of sound money and policy humility, would perform admirably. But it was not long before Friedman had reason to criticize Burns for compromising his prior beliefs in the service of political expediency. With Alan Greenspan, we see a similar story: a commitment to sound money and policy restraint—even admiration for the gold standard!—prior to his becoming a central banker, followed by politically accommodative policy after his becoming a central banker. Most recently, Ben Bernanke's Fed during the financial crisis behaved in a fundamentally different manner than Bernanke suggested in his public remarks. Bernanke insisted that the Fed behaved as an orthodox "lender of last resort," when in fact the Fed exceeded the acceptable bounds of last-resort-lending orthodoxy on almost every margin (Hogan, Le, and Salter 2013).

Central banks' bureaucratic structure also contributes to a great degree of status quo bias. Greg Mankiw (2006) notes that Fed economists, for example, frequently adhered to outdated ways of thinking—viewpoints that were incidentally much more comfortable with policy maker discretion and various forms of monetary tinkering—even after those ways had been demonstrated to be ineffective. Friedman appreciated this connection decades earlier, arguing that "[w]ith perhaps a few minor exceptions, the system has relatedly been unable or unwilling to change its methods of operation in

order to benefit from its own experience” (1982, 102). As academics gradually realized that central-banking “best practices” may favor a more predictable, hands-off approach, the Fed remained as intervention prone as ever.

Finally, central banks’ growing role as financial system overseers makes incentive problems even worse. Especially since the financial crisis, central banks have acquired greater direct control over their countries’ financial systems. This additional regulatory discretion, without meaningful checks on potential abuses, is dangerous. Regulation creates opportunities for rent seeking (Tullock 1967) by private actors, who can use regulation to create politically protected rents (Stigler 1971), which often results in an unlovely symbiosis between regulators and regulated. Regulators cater to the interests of the regulated, guaranteeing them politically secure rents in exchange for support and cooperation from the regulated. This symbiosis contributes to the monopolization of industry, with significant social costs for society created by the legal barriers to economic activity that guarantees a few key players excess returns to the factors of production. That this is a problem for central-banking systems was demonstrated recently by Carmen Segarra, a Fed regulator embedded within Goldman Sachs, who secretly recorded more than forty-six hours of work conversations (Bernstein 2014). The content of these recordings constitutes clear evidence of regulators’ overly deferential behavior to private-sector interests. Additional regulatory powers acquired by the Fed since the financial crises were intended to discipline the financial sector, but it is more plausible that they have merely further insulated a few key players from meaningful competition. These relationships are beneficial for the Fed and key private interests but costly for society at large.

The source of these incentive problems is the source of the knowledge problems. Central banks are not subject to any meaningful competitive discipline or pressure because they are nonmarket hierarchies with significant discretion. Combined with their top-down engineering orientation, this lack of competitive discipline creates significant opportunities for abuse. Unitary, consolidated, hierarchical monetary institutions are divorced from social processes, such as the market process, that foster error detection and correction. This insulation also guarantees there will be a gap between the interests of the governors and the welfare of the governed (Salter and Luther 2019). These problems cannot be fixed by changing operating policy or hiring the right people or any similar small-scale change. Malignancy is fundamentally institutional. To treat it, we need an institutional refurbishment of the monetary policy system.

## **Monetary Polycentricity: A Portrait of Health**

The cure for monetary monocentricity is monetary polycentricity. In social systems whose governance structure is polycentric, governance is fractured, overlapping, and concurrent. This means that no single authority can make all decisions; that there are multiple decision makers within a given jurisdiction who are entitled to contribute to

the governance process; and that the governance process is meaningfully consensual for both those who make the rules and those who obey the rules, with ideally a significant overlap between the governors and the governed. Due to fundamental institutional differences, polycentric governance systems often create a much more favorable knowledge-generating and incentive-aligning environment than monocentric systems. This is true in money and banking as well.

What would such a monetary system look like? The best historical approximations of polycentric banking systems are those that have been explored by scholars of *free banking*, also called *laissez-faire banking* (Selgin 1988, 1994; White 1989, 1995, 1999, 2015; Dowd 1992, 2015; Selgin and White 1994; Sechrest 2008; Fink 2014; see also Salter and Young 2018). Important examples include Scotland from the early eighteenth century through the mid-nineteenth century, Sweden during the first half of the nineteenth century, and Canada up through World War I. The theory and history of money and banking suggest several important institutional features. First, there are no specific regulations or other statutory restrictions on money and banking. The laws that govern this commercial practice are the same as society's general laws of property, contracts, torts, and so on. Second, there is no monetary authority whose goal is to promulgate what we understand as monetary policy. There may be a central bank in the sense of a privileged bank that receives political favor in exchange for extending loans to the government. Although such a bank is a regrettable departure from ideal free banking, especially since modern central banks have their historical roots in these politically favored organizations, to the extent it does not act like a regulator or an overseer it is unlikely to impugn the efficacy of the system. Third, there is no manipulation of the monetary order by the state, either in terms of altering the fundamental monetary unit or pressuring individual banks for credit. This implies a meaningful degree of "separation of money and state."

Under such a system, there is no such thing as monetary "policy." Nobody is harnessing the means of monetary control to tinker with economic outcomes; indeed, there is no single locus of monetary control. Private banks, operating for profit, take the existence of some fundamental commodity that serves as money, such as gold or silver, as given. These banks take deposits and use them to finance asset portfolios. They pay their depositors interest for the privilege of using their funds and earn some rate of return on their asset portfolios. The difference between what banks earn and what banks pay is their profit for conducting financial intermediation. (As an aside, this is possible only with fractional reserves. There is no such thing as 100 percent reserve-free banking.) Banks are free to issue notes to depositors, redeemable in the ultimate money-commodity. These bank liabilities come to be accepted as money if the banks in the system are financially sound. This is the usual course of affairs; although bank runs (massive flights of capital out of the banking system) did happen historically in free-banking systems occasionally, they are rare. They were much more common in systems that were constrained by costly regulations, which were enforced for political reasons and hindered the ordinary operation of the market mechanism in money and banking.

An interesting feature of this free-banking system is that banks have a profit-maximizing incentive to contribute to macroeconomic stability. For example, if the demand for money in the form of bank liabilities rises, banks will notice their internal reserves grow over time. This is a signal that the public is willing to hold a greater volume of liabilities—in essence, to give the banks a zero-interest loan. Banks can sustainably issue more liabilities for a given level of reserves when this is the case. In other words, the money supply responds to the needs of commerce in free-banking systems. Money and banking specialists call this responsive system a perfectly elastic money supply. Increases in money demand are quickly met with equal increases in supply. The reverse also happens: falling money demand means falling bank reserves, and banks contract their liabilities by retiring them. The unintended result of this process is a perpetual tendency toward monetary equilibrium—Adam Smith’s “invisible hand” obviates the need for a macroeconomic “man of system” as well!

In order for a governance system to be polycentric, agents within the system must interact with a network of overarching institutions and rules. These institutions and rules are the foundation of the system, performing the important work of generating knowledge and aligning incentives. We can speak briefly about three examples in free banking: the interbank clearinghouse, hard budget constraints, and extended-liability rules.

The clearinghouse is the chief source of endogenous stability in free-banking systems. In the course of business, competing banks come to acquire each other’s liabilities. They naturally wish to clear liabilities against each other in a way that minimizes transaction costs. This is the source of clearinghouses. Originally, they were simply the concretization of ad hoc clearing practices, growing in formality as banks discovered it was cheaper to clear their liabilities against each other multilaterally rather than bilaterally. Over time, the clearinghouses began to acquire additional functions, voluntarily adhered to by its member banks. These rules represented a *limited* degree of cooperation that promoted the integrity of the banking system without diverging into cartel-like anticompetitive behavior. Clearinghouses would maintain and enforce capital requirements, promote information sharing among banks about common concerns such as counterfeiting, and coordinate emergency loans during financially turbulent times, provided that the recipient bank was still perceived to be a viable commercial enterprise in the long term. Gary Gorton and Donald Mullineaux (1987) and Lawrence White (1989) note that these functions are similar to those intended by many statutes and other regulations applying to banks today. The difference is that because these functions were subscribed to voluntarily and emerged in bottom-up fashion, they were much more likely to be knowledge and incentive compatible for the agents within the system.

The next two functions comprise exogenous sources of stability in free-banking systems: they are conditions that banks in the system take as a given rather than as an institution they create in the course of their operations. The first is the omnipresence of a hard budget constraint. Banks in a free-banking system are ultimately constrained by the profit-and-loss system. Unlike monetary and financial systems today, there is no monetary authority that can create liquidity *ex nihilo* to bail out troubled firms. Any

emergency loan a bank receives must be paid for by other banks, which would not be willing to do so if they perceived a significant likelihood of not being paid back. The absence of a lender of last resort gave banks a strong incentive to moderate the risks they would accept on the asset side of their balance sheets. This is a notable contrast to today's systems, where, especially in large financial organizations, moral hazard has become common due to the institutionalization of "too big to fail" policies by central banks (see Hetzel 2008, 2012). The hard budget constraint also contributed to knowledge creation and dissemination: "with a hard budget constraint binding on the financial system itself, resources, including capital and risk, were subject to a competitive pricing process that could be used to determine the expected payoff of a portfolio and, in times of potential turbulence, to ascertain on what terms emergency loans between one bank and another would be mutually profitable" (Salter and Tarko 2019, 514).

The second source of exogenous stability was extended liability. Banks in historical free-banking systems could not incorporate on a limited-liability basis. They were forced to adopt some measure of extended liability: double, triple, or even unlimited (Salter, Veetil, and White 2017). This meant that a bank's owners could have their personal assets seized up to a specific amount if a bank was unable to pay its debtors. Like the hard budget constraint, extended liability obviously gave bank owners a strong incentive to economize on risk. It "also created the necessary environment for the knowledge-generating features of the market price system, which banks relied on in conducting their general intermediation services" (Salter and Tarko 2019, 514).

Each of these features has its malignant counterpart in a world of monetary monocentricity. Instead of governance through a clearinghouse subscribed to voluntarily by its members, in the monocentric system we have thousands of pages of statutes and regulations imposed in top-down fashion that impugn the efficiency and stability of the money and banking system. Instead of meaningful budget constraints, we have perpetual bailouts in the form of emergency loans and targeted asset purchases by central banks. And instead of extended liability clarifying the rules of the game and requiring bank owners to manage risk accordingly, we have limited liability (ordinarily an acceptable arrangement, but one that, combined with bailouts, creates the pernicious equilibrium of privatized profits and socialized losses) in conjunction with a host of tertiary policies that try to fix problems *ex post* rather than to create robustness *ex ante*. If we want a system that does not have a single point of failure and is subject to the discipline of the market process, we must look for institutional solutions informed by polycentric monetary systems rather than by monocentric ones.

### **Why It All Matters: Money in a Free Society**

Monetary monocentricity versus monetary polycentricity hinges on a crucial issue: Do we embrace "the rule of law or the rule of central bankers" in monetary affairs (White 2010)? In addition to economic consequences, this choice reflects a society's deep norms of and commitments to governance systems that are general, predictable, and

nondiscriminatory (Hayek 1960). Monetary monocentricity and its attendant malignancy are incompatible with a democratic society. As Vincent Ostrom (1997) recognized, there is an inherent connection between democracy and self-governance. A society cannot remain meaningfully democratic if its citizens vote to have their affairs managed by a distant bureaucratic class that is distinct from the general population in terms of education and expertise (see Callais and Salter 2020).

Viewed this way, polycentricity is an essential element in a society that embraces democratic self-governance. Polycentricity entails “a multiplicity of decision-making centers acting independently but under the constraints of an overarching set of norms and rules” (Aligica, Boettke, and Tarko 2019, 124), whereas monocentricity entails a single ultimate nexus of decisions, with few if any meaningful constraints on how those decisions are reached. Many mistakenly embrace monocentricity as a source of supposedly rational social rule creation, which serves the function of law. But for governance systems to be lawful, law must apply equally to the governors and the governed, neither of whose interests systematically depart from that of the other. Monocentricity is thus the source of *unlawful* behavior because it promotes a conception of governance as something done *by* one group of people *to* another group of people. Viewed this way, it is the antithesis of self-governance.

To make this argument more concrete, we can see that monetary monocentricity and monetary polycentricity embrace radically different views of money and its purpose in society. These views are incommensurate; there is no middle ground between them, no compromise to be reached, no difference to split. Monetary monocentricity requires that money be used as an instrument of social control. Furthermore, because of the inherent links between money and finance (Hendrickson and Salter 2018), control over money also implies control over finance. Not only the stance of monetary policy narrowly conceived—that is, the supply of money relative to the demand to hold it—but crucial aspects of the financial system, such as the price of credit and the content of specific intermediation practices, are subject to control by the monetary authority. The plans of market participants, including the entrepreneurs who drive the market process (Kirzner 1973), are overridden by central banks, who arrogate the right to control trade in order to promote their rationalistic-scientistic goals. Paul Aligica, Peter Boettke, and Vlad Tarko call this configuration the “seeing-like-a-state” paradigm: it privileges the governor as an expert and assumes a synoptic perspective from which the expert can manage others according to the expert’s own standards (2019, 23–24).

In contrast, a “seeing-like-a-citizen” perspective on money recognizes that money is first and foremost a tool of social cooperation (Zelmanovitz 2015; Salter and Furton 2017). Money provides for an incredible amount of coordination among consumers and producers, thus contributing to the further extension of the division of labor (Frankel 1977; Simmel 2011). In serving this function, money rightly deserves its lofty status as a “grammar of commerce” (Wagner 2010). Provided that its creation and dissemination throughout various markets adheres to a general rule—as it did in historical free-banking societies and as it does *not* in contemporary society under

discretionary central banking—money promotes the several interests of the citizens who make use of it in advancing their projects and thus contributes to the advancement of each while systematically disfavoring none. Furthermore, monetary relations are property relations; therefore, preserving the integrity of money is a case of preserving the integrity of property rights more generally. Whereas absolutist democracies are comfortable using the ballot box to run roughshod over private-property rights, self-governing democracies, which are the only ones worthy of the name, recognize that an infringement on the property rights of any is an infringement on the property rights of all. Thus, self-governing democracies view with skepticism calls for economic experts to be empowered to tinker with money because this power entails the right to tinker with *all* exchanges in the marketplace. Such an institutional arrangement would never be endorsed by rational individuals without significant constraints on the monetary authority's discretion (Buchanan and Brennan 1980, 1981). This is the source of monetary monocentricity's incompatibility with democracy: the principals whose interests the monetary authority is supposed to serve know that without binding rules the agents will usurp the role of the principals.

Ultimately, the malignancy we currently suffer because of monetary monocentricity is due to failures of theory and practice among monetary economists and macroeconomists. These economists have failed to recognize a basic tenet of political economy: there can be no coherent theory of economic policy without reckoning with the policies that public authorities will actually promote as opposed to the ones we would prefer them to promote. James Buchanan and Richard Wagner elegantly expressed this point, writing that economists must pay attention to the “political institutions through which economic policy must be implemented. . . . This necessary linkage between the basic political structure of society and the economic theory of policy has never been properly recognized by economists, despite its elementary logic and its overwhelming empirical apperency” ([1977] 2000, 4–5). Economists have overlooked malignant monetary monocentricity because their approach to monetary policy assumes away all the things that contribute to malignancy. This willful ignorance results directly in the failure of practice—namely, the lack of any clear evidence that U.S. economic outcomes have ever been improved by the Fed (Selgin, Lastrapes, and White 2012). Institutionalizing monetary monocentricity via the Federal Reserve System has consequently institutionalized malignancy along with it. The United States has never had a sound money and banking system that approximated free (polycentric) banking, but that is no reason to continue to embrace our current ineffective and undemocratic system.

Sound political economy recognizes that democratic self-governance and macroeconomic effectiveness are complements, not substitutes. We cannot trade off one for the other when choosing our monetary systems. A commitment to monetary polycentricity for reasons of self-governance delivers macroeconomic stability as a consequence. But if we tolerate monetary monocentricity because of the illusory promises of social control, we lose both self-governance and macroeconomic stability.

There is only one way to prevent malignancy: repudiate monetary monocentricity!

## References

- Aligica, Paul Dragos, Peter J. Boettke, and Vlad Tarko. 2019. *Public Governance and the Classical-Liberal Perspective: Political Economy Foundations*. Oxford: Oxford University Press.
- Aligica, Paul Dragos, and Vlad Tarko. 2014. Institutional Resilience and Economic Systems: Lessons from Elinor Ostrom's Work. *Comparative Economic Studies* 56:52–76.
- Beckworth, David. 2018. The Great Divorce: The Federal Reserve's Move to a Floor System and the Implications for Bank Portfolios. Mercatus Center, George Mason University. At <https://www.mercatus.org/system/files/beckworth-great-divorce-mercatus-research-v6.pdf>.
- Bernanke, Ben S. 2010. Central Bank Independence, Transparency, and Accountability. Speech at the Institute for Monetary and Economic Studies International Conference, Bank of Japan, Tokyo, May 25. At <https://www.federalreserve.gov/newsevents/speech/bernanke20100525a.htm>.
- . 2011. Implementing a Macroprudential Approach to Supervision and Regulation. Speech given at the Forty-Seventh Annual Conference on Bank Structure and Competition, Chicago, May 5.
- Bernstein, Jake. 2014. The Carmen Segarra Tapes. *ProPublica*, November 17. At <https://www.propublica.org/article/the-carmen-segarra-tapes>.
- Blinder, Alan. 2019. A New Tactic in Trump's War on the Fed. *Wall Street Journal*, July 15.
- Boettke, Peter J., and Daniel J. Smith. 2013. Federal Reserve Independence: A Centennial Review. *Journal of Prices & Markets* 1, no. 1: 31–48.
- . 2015. An Episodic History of Modern Federal Reserve Independence. *The Independent Review* 20, no. 1 (Summer): 99–120.
- Bordo, Michael D., and Edward S. Prescott. 2019. *Federal Reserve Structure, Economic Ideas, and Monetary and Financial Policy*. National Bureau of Economic Research (NBER) Working Paper no. 26098. Cambridge, Mass.: NBER. At <https://www.nber.org/papers/w26098#fromrss>.
- Buchanan, James M., and George Brennan. 1980. *The Power to Tax: Analytical Foundations of a Fiscal Constitution*. Cambridge: Cambridge University Press.
- . 1981. *Monopoly on Money and Inflation*. London: Institute for Economic Affairs.
- Buchanan, James M., and Richard E. Wagner. [1977] 2000. *Democracy in Deficit*. Indianapolis, Ind.: Liberty Fund.
- Callais, Justin T., and Alexander William Salter. 2020. Ideologies, Institutions, and Interests: Why Economic Ideas Don't Compete on a Level Playing Field. *The Independent Review* 25, no. 1 (Summer): 63–78.
- Dowd, Kevin, ed. 1992. *The Experience of Free Banking*. New York: Routledge.
- . 2015. Free Banking. In *The Oxford Handbook of Austrian Economics*, edited by Peter J. Boettke and Christopher J. Coyne, 213–46. Oxford: Oxford University Press.
- Dudley, Bill. 2019. The Fed Shouldn't Enable Donald Trump. *Bloomberg Opinion*, August 27. At <https://www.bloomberg.com/opinion/articles/2019-08-27/the-fed-shouldn-t-enable-donald-trump>.

- Fink, Alexander. 2014. Free Banking as an Evolving System: The Case of Switzerland Reconsidered. *Review of Austrian Economics* 27, no. 1: 57–69.
- Frankel, S. H. 1977. *The Federal Reserve Amendments of 1917: The Beginning of a Seasonal Note Issue Policy*. New York: St. Martin's Press
- Friedman, Milton. 1982. Monetary Policy: Theory and Practice. *Journal of Money, Credit, and Banking* 14, no. 1: 98–118.
- Galati, Gabriele, and Richhild Moessner. 2013. Macroprudential Policy: A Literature Review. *Journal of Economic Surveys* 5:846–78.
- Goodhart, C. A. E. 1975. *Problems of Monetary Management: The U.K. Experience*. Papers in Monetary Economics no. 1. Sydney: Reserve Bank of Australia.
- Gorton, Gary, and Donald J. Mullineaux. 1987. The Joint Production of Confidence: Endogenous Regulation and Nineteenth Century Commercial-Bank Clearinghouses. *Journal of Money, Credit, and Banking* 19, no. 4: 457–68.
- Hanson, Samuel, Anil Kashyap, and Jeremy Stein. 2011. A Macroprudential Approach to Financial Regulation. *Journal of Economic Perspectives* 25:3–28.
- Hayek, Friedrich A. 1948. *Individualism and Economic Order*. Chicago: University of Chicago Press.
- . 1960. *The Constitution of Liberty*. Chicago: University of Chicago Press.
- Hendrickson, Joshua, and Alexander William Salter. 2018. Beyond Monetary Constitutions: The Congruence of Money and Finance. *Quarterly Review of Economics and Finance* 69: 22–28.
- Hetzl, Robert L. 2008. *The Monetary Policy of the Federal Reserve: A History*. Cambridge: Cambridge University Press.
- . 2012. *The Great Recession: Market Failure or Policy Failure?* Cambridge: Cambridge University Press.
- Hetzl, Robert L., and Ralph F. Leach. 2001. The Treasury–Federal Reserve Accord: A New Narrative Account. *Federal Reserve Bank of Richmond Economic Quarterly* 87, no. 1: 33–55.
- Hogan, Thomas, Linh Le, and Alexander William Salter. 2013. Ben Bernanke and Bagehot's Rules. *Journal of Money, Credit, and Banking* 47, nos. 2–3: 333–48.
- Jordan, Jerry L., and William J. Luther. 2019. *Central Bank Independence and the Federal Reserve's New Operating Regime*. Sound Money Project Working Paper no. 2019-07. Great Barrington, Mass.: American Institute for Economic Research.
- Kirzner, Israel M. 1973. *Competition and Entrepreneurship*. Chicago: University of Chicago Press.
- Lim, Cheng Hoon, Alejo Costa, Francesco Columba, P. Kongsamut, Akira Otani, M. Saiyid, Torsten Wezel, and Xiaoyong Wu. 2011. *Macroprudential Policy: What Instruments and How to Use Them? Lessons from Country Experiences*. Working paper. Washington, D.C.: International Monetary Fund. At <https://ssrn.com/abstract=1956385>.
- Lucas, R. E., Jr. 1976. Econometric Policy Evaluation: A Critique. *Carnegie-Rochester Conference Series on Public Policy* 1, no. 1: 19–46.
- Mankiw, N. Gregory. 2006. The Macroeconomist as Scientist and Engineer. *Journal of Economic Perspectives* 20, no. 4: 29–46.

- Mises, Ludwig von. 1949. *Human Action: A Treatise on Economics*. New Haven, Conn.: Yale University Press.
- Mueller, Paul D., and Joshua Wojnilower. 2016. The Federal Reserve's Floor System: Immediate Gain for Remote Pain? *Journal of Private Enterprise* 31, no. 2: 15–40.
- Niskanen, William A. 1968. Nonmarket Decision Making: The Peculiar Economics of Bureaucracy. *American Economic Review* 58, no. 2 (May): 293–305.
- Ostrom, Elinor. 2010. Beyond Markets and States: Polycentric Governance of Complex Economic Systems. *American Economic Review* 100:641–72.
- Ostrom, Vincent, Charles M. Tiebout, and Robert Warren. 1961. The Organization of Government in Metropolitan Areas: A Theoretical Inquiry. *American Political Science Review* 55, no. 4: 831–42.
- Plosser, Charles I. 2018. The Risks of a Fed Balance Sheet Unconstrained by Monetary Policy. In *The Structural Foundations of Monetary Policy*, edited by Michael Bordo, John H. Cochrane, and Amit Seru, 1–16. Stanford, Calif.: Hoover Institution. Press.
- Quarles, R. K. 2019. Friedrich Hayek and the Price System. Remarks given at “The Road to Serfdom at 75: The Future of Classical Liberalism and the Free Market,” Ninth Annual Conference of the William F. Buckley Jr. Program at Yale University, New Haven, Conn., November 1.
- Rothbard, Murray N. 1960. The Politics of Political Economists: Comment. *Quarterly Journal of Economics* 74, no. 4: 659–65.
- Salter, Alexander William, and Glenn Furton. 2017. Money and the Rule of Law. *Review of Austrian Economics* 30, no. 4: 517–32.
- Salter, Alexander William, and William Luther. 2019. Adaptation and Central Banking. *Public Choice* 180, nos. 3–4: 243–56.
- Salter, Alexander William, and Daniel J. Smith. 2017. What You Don't Know Can Hurt You: Knowledge Problems in Monetary Policy. *Contemporary Economic Policy* 35, no. 3: 505–17.
- . 2019. Political Economists or Political Economists? The Role of Political Environments in the Formation of Fed Policy under Burns, Greenspan, and Bernanke. *Quarterly Review of Economics and Finance* 71:1–13.
- Salter, Alexander William, and Vlad Tarko. 2017. Polycentric Banking and Macroeconomic Stability. *Business and Politics* 19, no. 2: 365–95.
- . 2019. Governing the Banking System: An Assessment of Resilience Based on Elinor Ostrom's Design Principles. *Journal of Institutional Economics* 15, no. 3: 505–19.
- Salter, Alexander William, Vipin Veetil, and Lawrence H. White. 2017. Extended Shareholder Liability as a Means to Constrain Moral Hazard in Insured Banks. *Quarterly Review of Economics and Finance* 63:153–60.
- Salter, Alexander William, and Andrew T. Young. 2018. A Theory of Self-Enforcing Constitutions with Reference to the Suffolk System, 1825–1858. *Journal of Economic Behavior and Organization* 156:13–22.
- Sechrest, Larry J. 2008. *Free Banking: Theory, History, and a Laissez-Faire Model*. Auburn, Ala.: Ludwig von Mises Institute.

- Selgin, George. 1988. *The Theory of Free Banking: Money Supply under Competitive Note Issue*. New York: Rowman and Littlefield.
- . 1994. Free Banking and Economic Control. *Economic Journal* 104, no. 427: 1449–59.
- . 2018. *Flooded! How a Misguided Fed Experiment Deepened and Prolonged the Great Recession*. Washington, D.C.: Cato Institute.
- Selgin, George, William D. Lastrapes, and Lawrence H. White. 2012. Has the Fed Been a Failure? *Journal of Macroeconomics* 34, no. 3: 569–96.
- Selgin, George, and Lawrence H. White. 1994. How Would the Invisible Hand Handle Money? *Journal of Economic Literature* 32, no. 4: 1718–49.
- Simmel, Georg. 2011. *The Philosophy of Money*. Translated by Tom Bottomore and David Frisby. New York: Routledge.
- Stigler, George J. 1971. The Theory of Economic Regulation. *Bell Journal of Economics* 2, no. 1: 3–21.
- Tullock, Gordon. 1967. The Welfare Costs of Tariffs, Monopolies, and Theft. *Western Economic Journal* 5, no. 3: 224–32.
- . 2005. *Bureaucracy*. Indianapolis, Ind.: Liberty Fund.
- Wagner, Richard E. 2010. *Mind, Society, and Human Action: Time and Knowledge in a Theory of Social Economy*. New York: Routledge.
- White, Lawrence H. 1989. *Competition and Currency: Essays on Free Banking and Money*. New York: New York University Press.
- . 1995. *Free Banking in Britain: Theory, Experience, and Debate, 1800–1845*. 2nd ed. London: Institute of Economic Affairs.
- . 1999. *The Theory of Monetary Institutions*. Oxford: Blackwell.
- . 2010. The Rule of Law or the Rule of Central Bankers? *Cato Journal* 30, no. 3: 451–63.
- . 2015. Free Banking in Theory and History. In *Renewing the Search for a Monetary Constitution: Reforming Government's Role in the Monetary System*, edited by Lawrence H. White, Viktor Vanberg, and Ekkehard Köhler, 187–211. Washington, D.C.: Cato Institute.
- Yeager, Leland B. 1997. *The Fluttering Veil: Essays on Monetary Disequilibrium*. Indianapolis, Ind.: Liberty Fund.
- Zelmanovitz, Leonidas. 2015. *The Ontology and Function of Money: The Philosophical Fundamentals of Monetary Institutions*. Lanham, Md.: Lexington Books.

# SUBSCRIBE NOW AND RECEIVE A FREE BOOK!



“*The Independent Review* does not accept pronouncements of government officials nor the conventional wisdom at face value.”

—**JOHN R. MACARTHUR**, Publisher, *Harper’s*

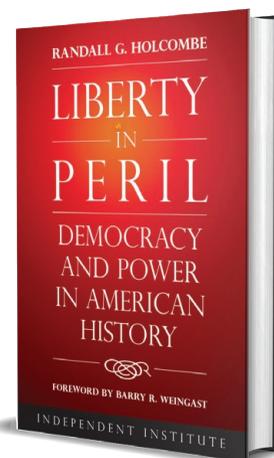
“*The Independent Review* is excellent.”

—**GARY BECKER**, Nobel Laureate in Economic Sciences

Subscribe to [The Independent Review](#) and receive a free book of your choice such as *Liberty in Peril: Democracy and Power in American History*, by Randall G. Holcombe.

Thought-provoking and educational, [The Independent Review](#) is blazing the way toward informed debate. This quarterly journal offers leading-edge insights on today’s most critical issues in economics, healthcare, education, the environment, energy, defense, law, history, political science, philosophy, and sociology.

Student? Educator? Journalist? Business or civic leader? Engaged citizen? This journal is for YOU!



Order today for more **FREE** book options

**SUBSCRIBE**

*The Independent Review* is now available digitally on mobile devices and tablets via the Apple/Android App Stores and Magzter. Subscriptions and single issues start at \$2.99. [Learn More.](#)

