Robert Greenfield , Leland B. Yeager

A Laissez-Faire Approach To Monetary Stability

Summarised by Turgay Hakan Ak

This article develops some diverse hints for a new monetary system(BFH System) offered separately by Fischer black. Eugene Fama. And Robert E. Hall. BFH system perfectly illuminates some characteristics of our existing and recent systems. The main idea of BFH system is to define the unit of account physically, in terms of many commodities, and not in terms of any medium of exchange whose value depends on regulation of its quantity or on its redeemability.

One fundamental difference between BFH system and either ordinary system relates to the supply and demand that determines the value of the unit of account. Under both fiat money and an ordinary commodity standard, the unit's value is determined by supply of and demand for money or a monetary commodity, with the demand being wholly (for fiat money) or largely (for commodity money) of a monetary character. Under the BFH system, in contrast, the demand for the many commodities defining the unit is almost entirely nonmonetary. The BFH system offers much less scope than an ordinary monetary system for destructive monetary disequilibrium. The BFH system would get rid of any distinct money existing in a definite quantity. The government would be forbidden to issue obligations fixed in value in the unit of account and especially suitable as media of exchange. It would not give legal-tender status to any particular means of payment but would simply enforce contracts in which the parties themselves had specified what would constitute fulfillment. No longer would there be any such thing as money whose purchasing power depended on limitation of its quantity. No longer, then, could there be too much of it, causing price inflation, or too little, causing depression, or a sequence of imbalances, causing stagflation. A wrong quantity of money could no longer cause problems because money would not exist. The prices of the individual commodities would not be fixed and would remain free to vary in relation to one another. Only the bundle as a whole would, by definition, have the fixed price of 1 unit. (for a unit of convenient size, however, the bundle might be designated as worth 1 *thousand* units.) BFH system is free of any link to issues of money that might become inflated. There is to be continuous adjustment of the redemption rate by indexing it to the prices of bundle of continuously traded standardized commodities rather than the CPI which is measured only monthly. The BFH system, in sharp contrast, abolishes any ordinary money in terms of which a price index might be calculated and so avoids any rivalry between distinct units of account.

With no money quantitatively existing, people make payments by transferring other property. To buy a bicycle priced at 100 value units or pay a debt of 100 units, one transfers property having that total value. Although the BFH system is barter in that sense, it is not *crude* barter. People need not haggle over the particular goods to be accepted in each transaction. The profit motive will surely lead competing private firms to offer convenient methods of payment.

There are many advantages of BFH system : Firstly, the system would provide a stable unit for pricing, invoicing, accounting, economic calculation, borrowing and lending, and writing contracts reaching into the future. The government, **secondly,** would come under financial discipline. **Thirdly**, competition under laissez faire would spur innovation in finance and the payments system and would exert discipline on banks and investment funds. A **fourth set** of advantages follows from the fact that the medium of exchange (i.e., readily transferable property) would not be redeemable in any particular base money, whether commodity money or govemment fiat money. Avoiding macroeconomic difficulties **is the another advantage.**

With BFH fund shares serving as the media of exchange, their actual quantity, measured in units of account, is determined by interaction of demand with supply. The **volume of media** of exchange is demand-determined in a BFH economy whose unit of account has a purchasing power dictated by its multicommodity definition. Under both our existing system and the bfh system, the real volume of media of exchange is determined by demand (interacting with supply); and under the bfh system, fixity of the unit of account means that the volume measured in it, the nominal volume, is demand-determined also. This condition shields the bfh system from the macroeconomic disorder that does accompany an excess demand for or supply of money in our existing system.

Under the BFH system the medium of exchange—or a major part of it, shareholdings in funds—**has a flexible price** in terms of the stable-by-definition unit of account. The total quantity of the medium of exchange—if that total is meaningful at all, in view of the vague and shiftable distinction between the exchange medium and investment assets—tends to adjust, to accommodate the demand for it.

People take the government-suggested unit seriously in expressing prices, debts, and accounts. That unit has no plausible rivals. In an ordinary monetary system, the unit in which the medium of exchange is denominated remains available as an altemative to any proposed commodity-bundle unit. Suppose that the BFH bundle were defined as 1 apple + 1 banana + 1 cherry. Prices are to be paid and debts settled in bundles-worths of convenient payment property. Now apples are struck by a fungus. By hypothesis, we know that bundles are now more difficult to obtain. And if it is more difficult to come by a BFH bundle, then it is more difficult to come by anything worth a BFH bundle. People therefore offer bundles—or bundles-worths of payment property—less eagerly than before in trying to buy miscellaneous commodities, whose prices therefore fall relative to the bundle itself. Now, the banana and the cherry, besides being components of the bundle, are themselves desired commodities. They therefore number among the goods for which people bid less eagerly in view of the hypothesized increased difficulty of obtaining bundles and so bundles-worths of payment property. The resulting fall in the prices of bananas and cherries counterbalances the increased unit-of-account price of apples.

In our simple example of a three-fruit bundle, the general price level comes under substantial downward pressure when apples are attacked by the fungus. If the bundle were more widely defined, the undisturbed supply conditions of the other items composing it would mitigate the deflationary impact of the worsened apple-supply conditions.

The BFH system of sophisticated barter does seem to avoid the disadvantages both of crude barter and of money as we have known it.

Strengths	**Weaknesses**
Cashlessness ''Government is the only agency which can take a useful commodity like paper, slap some ink on it, and make it totally worthless.'' Ludwig Von Mises	Operationality , Is Bundle Worth redemption workable?
An alternative system / offers many advantages	Desirability / Benefits of base money underappreciated
Illuminates some characteristics of our existing and recent systems.	Circularity problem

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