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Money and savings: how definitions affect policies[1]

January 16, 1991

Money and
savings

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I. The issue and its importance

The subject of this paper is stated in its title. An attempt will be made to demonstrate how lack of precision in the use of terms leads to lack of precision in theories, which in turn leads to errors or misunderstandings in policies. The case in point has to do with some economic terms most frequently in use – money, credit and savings. The principle, however, applies generally in economics, which uses terms that are also in common use.

The varied means and lack of precision that accompany the use of these terms apply also to related terms such as deposits, *encaje* [bank reserves plus forced investments], and reserves. There are doubtless various reasons why economics is often characterised as an inexact science, but at least one must be the common use of some of its fundamental terms in senses different from their use by professionals. And, it must be admitted, the professional economists do not always concur in the meanings they themselves attach to terms.

The most basic terms in economics are supply, demand and value. Much of economic theory is concerned with the infinitely varied applications of the “laws” of supply and demand in the short and longer term, in the determination of value, in the reactions of value back on supply and demand. What appears at first sight as a very simple relationship turns out to be highly complex in some of its applications. If the concepts of supply and demand and price or value are to be applied to money one would think that it is of the utmost importance that money be distinguished from what is not money. But there is a lack of consensus on what criteria can be used to distinguish money from other things. Great Britain has a variety of terms and accompanying series for money and, in effect, has no single term for the stock of money in circulation. The USA has a series for M_1 , a synonym for money, and another one for M_2 , the latter being over three times the quantity of the former. Great confusion has resulted. Colombia has a series of means of payment, which is composed of *efectivo* [cash] in the hands of the public and *cuentas corrientes* [current accounts, or demand deposits]. But there are other series of “*cuasi dineros*” [near-moneys] and “*oferta monetaria ampliada*” [broad money supply].

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[1] [Ed.: A version of this paper was published in Spanish as “Como las definiciones pueden afectar las políticas”, *Revista Desarrollo y Sociedad*, (Bogota: Centro de Estudios de Desarrollo Económico, CEDE, University of the Andes), No. 28, September 1991. Currie uses some Spanish words in his English text. These I have either translated directly or within square brackets after the Spanish word or phrase.]



Journal of Economic Studies
Vol. 31 No. 3/4, 2004
pp. 371-381
Emerald Group Publishing Limited
0144-3585

But does a definition of money and series of money really matter? Or is it of concern only to a few professional economists? The view here is that it matters greatly as it is bound up with monetary policy and hence with the issues of price stability and monetary control. If one is not aware of what one is controlling, the prospect of effective control and of overall price stability, that is, stability of the value of “money”, is not bright. If, for example, savings in the form of *cuentas de ahorro* [savings deposits] are “like” money, then presumably the same concepts and policies as apply to money apply to *cuentas de ahorro*. And if to such *cuentas*, why not to other forms of saving? Evidently, the definition of money is of major importance.

II. Antecedents

Historically speaking, the ambiguity of the terms is comparatively recent and is associated with the development of deposit banking and the transference of funds by means of orders on banks [checks]. Previously “money” was a means of payment which either had value in itself (“hard” currency) or was accepted as having such value. The characteristics were liquidity (general and immediate acceptability) and security.

The ambiguity arose when orders on banks acquired these characteristics. An important characteristic of money that was overlooked was the limitation of its supply. In economics, things in unlimited supply, regardless of how “basic” or “necessary” they may be, have no value. Galbraith graphically tells the story of the consequences of “over” creation of bank deposits in the early days of deposit banking. However, even as late as 1913 in the creation of the Federal Reserve System, there was no clear conception of how to control the new form of money, except that adherence to the gold standard at a fixed price of gold was believed to provide the necessary limitations on the supply of money. The task of the new system, in the view of its framers, was to provide “credit” or liquidity to prevent the various periodic “crises”.

The academic definitions of money that came into vogue in the early twentieth century stressed the “means of payment” function of money which it was thought was in turn derived from something possessing a high degree of liquidity and security and could be used as a “store of value” and “unit of account”. The difficulty on which a definition stressing liquidity and possessing the characteristics on which liquidity is based was that it could be satisfied by a number of financial instruments. Instead of clarifying the issue, it further confounded it. Much time was spent and wasted in seeking to give significance to the term “liquidity”. One of the consequences was a new category of certain savings, with high liquidity, being called “like money”.

In the resulting confusion, what had always been an essential characteristic of money – the limitation of its quantity – was lost sight of or understressed. So with the general abandonment of the gold standard in which money was convertible at a fixed and constant price for an ounce of gold, the ultimate limitation on the amplified means of payment was lost and various and successive orgies of hyper-inflation ensued, in which money lost its value. It appears essential, therefore, that any definition of money that will serve for policy purposes must include the characteristic of its being limited in supply and preferably is something whose supply can be controlled.

III. Definition of money: a first approximation

As a first approximation, then, money may be defined as a means of payment held by the public whose supply is limited and can be subject to control. It has been objected to that the volume of cash (coins and bills) in the hands of the public is not subject to control, as the public is free to convert deposits to cash (and vice versa) at any time so that the volume of cash depends on the effective demand of the public for cash. It is true that the limited supply of metal no longer constitutes a limitation on the supply of "bank notes" all of which are paper. However, as long as a large portion of money consists of *cuentas corrientes* [demand deposits], which are subject to control, the total volume may be said to be subject to control.

It is a commonplace of monetary theory that demand deposits are a multiple of the required volume of commercial bank reserves which consist of cash-in-hand and deposits in the central bank, both non-earning. An increase of such reserves of 1 million, when required reserves are 10 percent of demand deposits, permits an expansion of 10 million of these current accounts and 9 million of *cartera* (earning assets). (It is assumed that commercial banks maintain the required amount of reserves, no more and no less.) As long, therefore, as the monetary authorities can change either the volume of commercial banks' reserves, or the percentage of such reserves required to be held, they can control the volume of the variable and largest portion of what we have defined as money.

It will be noted that the words "held by the public" or "in circulation" exclude from "money" bank notes and/or coins held by commercial banks, or their deposits with the central banks. It also excludes gold or foreign reserves held by a central bank. In fact, under this definition, the central bank has no money! It does, however, in logic include cash and deposits held by non-commercial bank financial institutions. It is necessary to make these distinctions in order to give precision to the word "money" and to the control of the supply of money.

IV. Supply, demand and money

Mention of the supply of money raises another point. As the most important single set of concepts in economics in general has to do with the interactions of supply and demand and price (or value), can the laws of supply and demand apply to money? The price of most things can be expressed in terms of money or the unit of account. The value of the unit itself however, is expressed in terms of its purchasing power over goods and services in general. This is generally expressed in terms of changes in a weighted index of final or consumer goods. On this there is general agreement. The difficulty is with the definition of the supply and the demand for money. At this point arises the importance of a definition, as clearly the concepts of supply and demand should apply to the same thing. In popular speech they do not do so. Thus by the "demand for money" is frequently meant either the demand for income or the demand for loans (as in the "money" market) and the supply of money is frequently used in the sense of patrimony or property ("he has a lot of money").

What is important in defining money is that one takes account, on both the demand and the supply side, of *all* the factors determining its value. Fortunately, the absolute volume of the supply is not as important as the *changes* in the supply in relation to changes in the supply of final goods and services being produced and offered for sale.

Having decided on what one is going to call the supply, it is equally important that what one calls the demand for money refers to exactly the same entity and volume as does the supply.

For the purpose of policy formulation it is important that the supply and demand be capable of measurement and dealt with in quantitative terms. Finally, it is important that changes in the supply be subject to control and that unwanted changes in the demand can be offset so that the value of money can be controlled.

It is believed that these requirements can be met in Colombia. If money is defined as means of payment, that is, as M_1 , or cash and demand deposits in the hands of non-commercial banks or "the public", one has a specific quantity whose total is known and whose changes can be measured at various time intervals.

V. More on the demand for money

So two of the basic elements for applying the apparatus of supply and demand to money are at hand – the supply and the value. What is most difficult for a non-economist to grasp is the meaning of demand as applied to money.

What makes it difficult is that the definition is the exact opposite of the customary or popular conception. It is the demand of the community for money to *hold* or *not* to spend. It is the demand for money as purchasing power or, as another popular expression has it, to keep by one as "ready cash". This demand can be expressed quantitatively as a percent of the gross national product. (Strictly speaking, as the net national product, but for monetary purposes the difference is not significant). If, for example, the stock of money is equal to 20 percent of the PIB [*producto interno bruto*, which translates as GDP, though Currie has just mentioned GNP rather than GDP], one may express the demand of the public as defined as being for a sum equal to 20 percent of PIB. It will be noted that this percentage is the reciprocal of the more familiar concept of the income velocity of circulation of money (in this instance being the reciprocal of 20 percent, which is 5) which is obtained by dividing the income by the stock of money.

By defining the demand in this way one resolves the familiar intellectual difficulty that supply is always equal to demand (made so by changes in prices) and can more easily conceptualize a change in demand (or income velocity) and what may cause such a change. Thus if both supply of money (as defined) and the PIB increase by 5 percent, the demand for money may be said to have remained unchanged (or that the income velocity has remained at 5).

If, however, the public does not wish to continue to hold 20 percent of its income in the form of money, that is, if the demand for money as defined declines, this will be shown as an increase in the income velocity of money. It has become the custom to use the letters k and V for the demand for money and the income velocity. The advantage of using the less familiar concept of demand rather than velocity is that it more clearly applies the general apparatus of supply and demand to money and enables one more easily to envisage exogenous changes in demand, whereas velocity appears more as simply the arithmetical result of a division of income by money.

So it is seen that the endless arguments on the definition of money being dependent on the degree of its liquidity become irrelevant. In dealing with money the important issues are the impact of changes in its supply and demand on the national income in

monetary terms and on the price level or value of money. By definition, movements in nominal national income can be accounted for or broken down into changes in M_1 multiplied by changes in V , the reciprocal of demand for money. Insofar as instruments “like” money have an impact on income and price, their effect may be treated as affecting the demand for money to hold or, in some cases, on the supply of M_1 . Thus an extension of the use of credit cards may lessen the demand for that portion of money that is in the form of cash but it is questionable whether it reduces the demand for money as defined. If, however, it does so it will show as an increase in the income velocity of money. For a time there was concern that a requirement by some banks that their borrowers hold a certain portion of their loans as deposits added to the supply of money. Since this practice did not affect either the volume of commercial bank reserves nor reserve requirements, it could not affect the supply of money. It may have increased the demand and hence acted to reduce velocity.

The same reasoning can apply to the growth in time deposits or *cuentas de ahorro* [savings accounts]. The only effect such a growth can have on the PIB [GDP] and prices would be restrictive since, if there are reserve requirements against such deposits by regulation or by custom, an increase in such reserves will be at the expense of the volume of commercial banks’ reserves against demand deposits. Suppose that reserves required against checking accounts are in the neighbourhood of 50 percent and against savings accounts, 5 percent. Suppose further that there is a *traslado* [transfer] of deposits of 1 million from current accounts to savings accounts. Initially the deposits and reserves of CAVs [*Corporaciones de Ahorro y Vivienda*; savings and housing corporations] rise by 1 million and those of commercial banks fall the same amount. The moment the CAVs use these funds they pass once again to current accounts and restore the previous level. M_1 remains unchanged but savings accounts have increased by 1 million (actually commercial banks lose 5 percent irretrievably of the initial loss of deposits now tied up in the form of a 5 percent reserve against the new savings accounts). The “transference” or substitution turns out not to be a transference or substitution. Saving in this form could grow indefinitely without affecting either the volume of M_1 or V and hence not be in any way inflationary. Actually, there is no *monetary* need for required reserves against savings deposits, either in the CAVs or in the traditional form [that is, in banks]. Any increase in reserves against savings accounts means a hidden and indirect loss of reserves that would otherwise be available against current accounts. They act as monetarily restrictive, just as does *any* increase in any deposit other than commercial banks in the Banco de la República.

By restricting the definition of money to demand deposits and cash one does not lose account of any impact of instruments or practices on income and prices, but treats such an impact in a more orderly way as affecting the supply or demand for what has been agreed to call money.

But, it may be objected, this still makes the definition of money arbitrary, rather than functional. The same equation $M_1 \times V = \text{GDP}$ could be applied to $M_2 \times V(\text{of } M_2) = \text{GDP}$. It will be maintained here that while the latter statement [sentence] is true, the former [sentence] is not, and that the restriction of money to M_1 can be defended as being both functional and necessary for policy purposes.

VI. Changes in the demand for money

In Colombia the global figure of income velocity of money rose from 7 in 1960 to 11.2 in 1989 and in the USA from 3.6 in 1960 to 6.8 in 1989. In other words, the Colombian community's holdings of M_1 as a percent of current income are considerably lower than they were in the past and lower than the holdings of US citizens. (Actually in the latter case, the figure is lower if full allowance could be made for the holdings by foreigners of US currency outside the USA.)

Although Friedman was wrong in thinking that in explaining movements in the price level, changes in the demand for money could be ignored, he was right in stressing that the movements are small in relation to the actual and possible changes in the supply of money. While an index of changes in demand for money in Colombia fell from 99 to 64 from 1972 to 1989, an index of the supply of money in the same period rose from 689 to 35,465 (both with a base of 100 in 1960). Obviously, to account for a rise in the index of the price level in the same period from 370 to 14,712, stress must be laid on the enormous increase in the supply of money.

For much of the time in the past it was approximately true to say that if the supply of M_1 increased no more rapidly than the output of goods, the price level would be stable, and that, in general, the rise in the price level could be explained in terms of the increase in the supply of money. Unfortunately, however, if the expansion of money is such as to cause a rise in prices, there is a tendency for this to be exacerbated by a rise in velocity or a fall in the demand for money. To each and every individual it appears that the loss of possible income rises with a rise in prices, especially as the latter is usually accompanied by a rise in market rates of interest. On the other hand, if for a time, stability of prices can be maintained, the demand for money will tend to stabilize, with reductions reflecting only reductions in the administrative cost of handling payments by use of checking accounts[2].

Table I shows the means of payment as defined here, the gross national product in nominal terms, the income velocity of circulation and the demand for money as a percent of nominal income[3].

Chart I [not reproduced here] shows that from 1960 to 1972, a period of modest inflation and interest rates, the average demand for money remained stable, although there were variations from year to year. From 1972 to 1990 the demand for money declined and its reciprocal, the income velocity of circulation, rose from 7.2 to 11.2. The latter period was one of much higher inflation and higher nominal interest rates. The impact on income in nominal terms of the increase in the supply of money was exacerbated by a decline in the demand.

[2] [Ed.: See "A new hypothesis on the demand for money: the 'accounting' motive and banks' costs", December 1992, reproduced in this volume below.]

[3] [Ed.: This table is not reproduced here, but it gives annual data, 1960-1989, on the money supply (M_1), GDP, velocity (GDP/M_1) and " k " - the demand for money as a percent of GDP (M_1/GDP). Between 1960 and 1972, velocity varies within the range of 6.6 to 7.3, and " k " between 13.8 percent and 15.2 percent. From 1973 to 1989 velocity varies between a low of 7.3 (1973) and a high of 11.2 (1989), with " k " moving from 13.6 percent in 1973 to 8.9 percent in 1989. These annual movements in V and " k " are also shown in Chart I, not reproduced here.]

VII. The definition of money again

If there is a demand for money as such and to hold, and to satisfy this demand entails a cost, it is presumably performing a distinct service for which holders are willing to pay. At this point it is helpful to distinguish between the individual and the social cost. To an individual the cost is the loss of return on the sum represented by the *efectivo* (cash) or *saldo* (current account balance) that it might be earning if “invested” (or for the smaller accounts, the foregoing of the use of goods that might have been purchased). Willingness to accept such a cost is explained in the text books as that the holding of money bridges the gap between receipts and expenditures or provides liquidity, acts as a means of payment and serves as a store of value. These functions apply especially in the case of holdings of cash. However, this explanation is not completely satisfying in accounting for the holdings of large deposits, and it is these deposits that comprise the bulk of checking accounts. In 1987 accounts which, converted to dollars, were over US\$2,000 each, amounted to 50 percent of the volume. Yet the opportunities to invest in highly liquid and secure other outlets were abundant. It appears, therefore that this demand for money must be such as to explain the existence of a number of very large accounts for which neither the transactions, nor the liquidity explanations are satisfactory.

An explanation that appears plausible is that the provision of the bookkeeping or accounting services provided by banks is costly and must be paid for by someone. Banks provide this service and expect to be repaid by the interest on the loans made possible by the deposits of customers. The cost to banks for handling 47 billion checks in the USA in 1987 was calculated by US\$15 billion or 32 cents per check[4]. The operative cost of demand deposits, a somewhat wider category, was calculated by US\$19 billion. These costs were covered in part by charges made directly on depositors but mainly from the loan income from deposits. The larger deposits were presumably mostly accounts of large business firms, whose daily flow of receipts and expenditures could have been sufficiently predicted so as to permit advantage to be taken of the abundant opportunities to invest over night or in short-term funds, and so could have been actually much lower on the average. The puzzle is why they carry such apparently unnecessarily large balances. One explanation may be that the banks bring some pressure on them to do so. Another explanation is that the larger depositors shift most of the imputed cost of idle balances to the receivers of their checks. The balance of an account in the accounting of an individual depositor may differ (and be much lower) than the balance in the accounts of his bank. So, for at least a portion of the money supply, the “demand” is by the recorded owners of checking accounts, but the “cost” is borne in part by both the receivers of checks of those owners and by the banks.

This, it must be repeated, is looking at demand and costs at a micro level. In macro or social terms, the cost of processing checks of the community is calculated as the administrative cost to the banks plus the unrecorded expenditure of time and resources of the public that use and receive checks. While the above analysis of a portion of the

[4] Data from *Functional Cost Analysis, National Average Report, 1987*, Washington DC, Federal Reserve Board, and David B. Humphrey and Allen N. Burger, “Market failure and resource use: economic incentives to use different payment instruments”, in David B. Humphrey (Ed.), *The US Payment System*, Norwell, MA, Kluwer Academic Publishing, 1990, pp. 55, 83.

demand for money may appear unnecessarily detailed, it is in reality still superficial and is designed merely to indicate why, in dealing with large numbers and with a maze of motivations, it is not surprising that the overall demand for cash and for demand deposits should be relatively stable and bear a fairly constant relation to the value of the physical volume of production per year with a secular tendency to decline (rise of velocity) in reflection of the increasing efficiency in processing checks, the rise in interest rates and the reduction in the holding of currency in relation to income. That the demand is not completely stable, as the earlier Quantity Theorists believed, is no good reason for expanding the definition of money, as did Milton Friedman, to include time and savings deposits whose volume is not subject to control or to say that the definition of money does not matter. The more logical course is to use the control over supply of M_1 to offset as far as it is thought desirable the relatively low yearly changes in the overall demand for money.

What has been attempted here is to show that money, especially, is not only a means of payment, but its holding or existence also performs a valuable service in itself and entails a separate cost which is born by various segments of the economy. It is this service and cost that distinguishes the current accounts portion of money from other things used as a means of payment. Moreover the volume of checking accounts is subject to control. As providing a service entails a cost, there is an incentive to keep the cost as low as possible, which tends to make for relative stability in the demand for money or its velocity.

Even where some checking is permitted against some deposits that pay interest, as in the USA, this practice reduces considerably the interest that can be paid in comparison with the open market. The cost of unlimited checking, which is what is usually required by business firms, is high and does not permit the payment by banks of market rates of interest. Thus it may be argued that there is special demand for checking accounts for this particular function of money of accounting and security in payments.

VIII. The means of control of supply of money: the “*encaje*” [frozen balances]

As remarked above, the volume of checking accounts is a multiple of commercial banks' holdings of currency and deposits in the central banks in relation to the reserves required to be so held, expressed as a percentage of checking accounts. If the reserve requirements are 10 percent against demand deposits an addition of 1,000 in reserves permits a total expansion of 10,000 in deposits and 9,000 in earning assets. Commercial banks customarily maintain reserves at the required level and not above that level. Hence the central bank's ability to vary either reserves or requirements constitutes its means of control.

Depositors are often led to think that they can vary level of current accounts by adding or lessening their balances. They can do so by depositing or withdrawing currency, but this operation changes the form or composition of M_1 rather than the volume (unless it leads to a multiple expansion or contraction of current account deposits because of a net loss or gain in commercial banks' reserves). The same may be said of deposits of foreign exchange or withdrawals to buy foreign currency. Both these operations may be thought of as coming from *outside* the internal banking

system. Consignation or withdrawals *within* that system do not affect commercial banks' reserves except insofar as non-commercial banks are required to or prefer to maintain reserves in the form of currency or deposits in the central bank. A shift of deposits from a commercial bank to a *corporacion de ahorro* [savings and loan association] returns to commercial banks when it is "loaned" and spent by a borrower, except for the amount required in an *encaje* [frozen or "encaged" balances, as required reserves or forced investments].

In addition to the power to change reserve requirements, a central bank may affect the *volume* of commercial banks' reserves by buying and selling securities to the banking system or its customers and in various other ways.

Hence from the point of view of monetary theory and policy, the function of the *encaje* [frozen reserves] against current accounts is that of control and differs from accounting, liquidity or security purposes. It is true that an increase in reserve requirements against *cuentas de ahorro*, or time or saving deposits, is "restrictive" but this is only because such an increase decreases the amount available to act as reserves against current accounts. It has no more effect, nor economic justification than would the imposition on the residents of certain *barrios* or cities the obligation to maintain balances in the Banco de la República.

The justification of the *encaje* on current account deposits is that the State, through the central bank, has created for the commercial banks part of their raw material – demand deposits. The imposition of a high *encaje* in time of inflation is not an arbitrary form of taxation. It is an action of the State to sterilize a portion of the large emission of money it has created or acquiesced in creating.

IX. Saving and saving deposits

This lack of definitions and precision is, if possible, even greater in this field. There are literally hundreds of things that in one aspect or another are called savings. In macroeconomics, saving is a residual – the difference between consumption and what economists choose to call income, which is also the difference between income and investment, so that savings equals investment. Savings are composed of personal, private and public savings and may be adjusted for net international saving. It will be seen that these various senses of the term have little to do with the deposits of one or another type of institutions. These latter may arise from an excess of current income over consumption, from deposits or instruments of debt previously held elsewhere, and indeed from a variety of sources. They form a portion of debt which is the counter-face of credit. The enormous creation of debt piled on debt (leverage) of the Reagan years had nothing to do with the supply and demand and value of money. If a portion of this credit or debt is treated as tho it were money, all precision in the use of terms and concepts is lost. A few economists have attempted to treat of the total debt and total credit but without tangible result and almost no use of the totals is made in modern textbooks in macroeconomics.

On occasion the State has attempted to increase business savings by reduction of taxes, or personal savings thru imposition of taxes for old age benefits. These attempts have rarely been successful in changing the volume of savings tho a notable exception has been Singapore where the State ensured that such savings were used in construction. They financed a building program which, in relation to the GNP, was

probably the largest in the world and with no inflationary effect. Equal sums created as means of payment would have been highly inflationary.

Savings take many forms and the demand arises from many sources. The equilibrating agent between supply and demand is seen to be the rate of interest or return. New bank credit is but a small portion of loanable funds. While the immediate impact may be expansive if it arises from the creation of new money, it tends to *raise* the rate of interest because of inflation and increased demand for loans. Hence the central bank has little if any control over the rate of interest, or the price of savings.

Failure to make a distinction between money and savings was doubtless the cause of the application of 100 marginal *encaje* against traditional savings and *certificados de depósito a término* [certificates of time deposit (CDTs)] in Resolution 1 of 1991, implying that such savings are money. The exemption of savings deposits was apparently not because they were savings but because of their use in construction loans. It appears that the concept of monetary control was intermingled with that of credit control.

The inclusion of forced investments in the “*encaje*” against traditional savings and time deposits is another example of the imprecise use of terms. For monetary purposes the only “*encaje*” that matters is composed of banks’ deposits in the Banco de la República plus cash in the vaults of the commercial banks. In English the term is “reserve”, but this term, in turn, is used in different contexts.

X. Money and credit

While “money” may be regarded as an asset by its holder, what is used as money (cash or demand deposits) is a liability either of a commercial bank (as deposits) or of the Central Bank (bank-note) or of a government. The distinction has been blurred by the interchangeable use of the terms monetary and credit policies or simply money and credit. For many years after its foundation in 1913 the Federal Reserve System of the USA regarded itself as primarily a credit system – hence the creation of 12 reserve banks and such terms as “lender of last resort” and “accommodating” business. It was only in 1935 that primary weight was given to its monetary function. The same was true up to a much later date of the Banco de la República. The theory that it was the peculiar responsibility of a central bank to make credit available for certain purposes believed to be more “productive” than others, such as agriculture, was long held and is still held in certain quarters. Now that the superior efficacy in general of market forces for the allocation of resources is accepted, and people have become more sophisticated in macroeconomic theory, the doctrine of selective credit control as a Central Bank’s responsibility has lost ground.

Conclusion

This paper has sought to show the confusion that has arisen from the imprecise and ambiguous use of such terms as money savings, credit and investment. An essential step to correct the confusion would be the recognition that the most important portion of means of payment is that which performs a distinct service for which there is a demand and which entails a cost for which the community in various ways is prepared to pay. Money as so defined is subject to the laws of supply and demand and to the control of its volume.

Postscript, August 5, 1991

The difficulty of controlling the volumes of money in 1991 does not, it is believed, affect the validity of the argument of this paper. When a currency is convertible, as was the case of the peso of that year, the movements of capital from abroad may be so large as to create difficulties in preventing an increase in the reserves of banks, especially when the Central Bank has no stock of saleable government bonds at hand and resorted to creating *titulos* [bonds][5]. Moreover, recourse was had to a 100 percent marginal reserve requirement which served to sterilize the secondary expansion of current account deposits, but not the primary. To do the latter a more than offsetting increase in average reserve requirements would have been more effective. The heavy sale of bonds both to offset the inflow of funds and to cover the large refunding requirements in turn made for higher short-term internal rates and further inflows. This is a situation the US monetary authorities do not face as the dollar is an inconvertible currency and the Fed has on hand a large accumulation of marketable government bonds for use, when necessary, in open market operations.

[5] [Ed.: Presumably this means that the Government issued new bonds for sale to the public.]