

FUNDAMENTAL REAPPRAISAL OF THE DISCOUNT MECHANISM

**THE LEGITIMACY OF
CENTRAL BANKS**

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The Legitimacy
of
Central Banks

by

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The problem of legitimacy is one of the most neglected aspects of the study of social systems. There may be good reasons for this, for it is inevitably a hot subject. One can hardly discuss the legitimacy of anything without seeming to threaten it, for a great deal of legitimacy depends on things being taken for granted and not talked about at all. The more one looks at the dynamics of social systems, however, the more it becomes clear that the dynamics of legitimacy is one of the most important elements in the total long-run dynamics of society. It certainly ranks with such things as population and demographic movements, and even with technological change with which it is closely intertwined. Its importance can be seen in the remark that if a person or institution loses legitimacy it loses everything. It can no longer maintain itself in the social system. No amount of wealth, that is exchange capability, or power, that is, threat capability, can keep an institution alive if there is a widespread denial of the legitimacy of its role in society. This is because the performance of any continuous and repeated role requires an acceptance of its legitimacy on the part of those role occupants whose roles are related to it. A role in the social system is a focal point or node of inputs and outputs of many different kinds, the output of one role being the input of another. Inputs, therefore, depend on the willingness of other role occupants to give outputs, and they will not do this continuously unless there is legitimacy. Where people feel that certain outputs

are illegitimate they will eventually find ways of stopping them. The corresponding inputs will likewise stop. To use a rather crude illustration, a bandit can take your money once, but anyone who wants to take it every week either has to be a landlord or a tax collector, or perhaps even a bank.

There are a considerable number of sources of legitimacy, and the functions which relate the determinants of legitimacy to its amount are extremely complex. They are certainly non-linear and they exhibit discontinuities which are, to say the least, disconcerting. Sometimes an institution, the legitimacy of which seems to be absolutely unquestioned, collapses overnight. All of a sudden we reach some kind of a "cliff" in the legitimacy function and the institution suddenly becomes illegitimate. The same thing perhaps can even happen the other way, in which institutions quite suddenly become legitimate after having been illegitimate. A good example of the former is the collapse of the monarchy, beginning in the 17th century. The legitimacy of monarchy survived the Cromwellian war in England, largely because an ancient legitimacy is like a capital stock, it takes a great deal of spending before it can be exhausted. At the time of Louis XIV in the following century one might have thought that the legitimacy of monarchy was absolutely unquestioned and secure. In the following century, however, it collapsed everywhere and the only monarchs who survived were those who abandoned their power and became symbols of legitimacy, like the British, Dutch and Scandinavian monarchs. On the other side, abortion

has been an institution which has been regarded as highly illegitimate and now in the face of the population problem seems to be acquiring a quite sudden legitimacy.

at least

We may distinguish ^{at least} six classes of sources of legitimacy, that is, of variables in society which are functionally related to it. The first consists of the payoffs of the institution in question. If an institution provides good terms of trade with those who are related to it, up to a point this contributes to its legitimacy, especially in the long run. The case is clearer on the negative side. An institution which has very poor payoffs, demands a great deal of input from other people and gives very little output to them, is likely to have its legitimacy eventually eroded on this account. The relationship, however, is certainly non-linear and quite complex, and at times may even be negative. Just because an institution is useful and pays off well is not sufficient to give it legitimacy.

The main reason for this, paradoxically enough, is that it is not merely good payoffs that give legitimacy but also bad payoffs, that is, sacrifices. A sacrifice or "grant" may be defined as a one-way transfer from one decision unit to another, by contrast with exchange, which is a two-way transfer, from A to B and also from B to A. The structure of one-way transfers of commodities and exchangeables, I call the "Grants" economy, and it is a good first approximation measure of the extent and structure of the integrative system in general. If A makes a grant to B, the implication is that A identifies with B, A and B

are in a community together, and A clearly regards B as legitimate. The dynamics of the grants system is very complex because to some extent grants are self-justifying. If A makes sacrifices to B for B it is very hard for A to admit to himself that these sacrifices have been in vain. This would be a threat to his identity, which is the greatest threat that any person can feel. There is, therefore, a strong tendency to "throw good money after bad," and to continue making sacrifices for some institution, even after some possibly expected long-run payoffs have failed to materialize. This is what I call the "sacrifice trap." We see this in the family, for instance, where the devotion of one spouse to a very unsatisfactory partner often continues for a long time in spite of very unsatisfactory internal terms of trade. A spouse who gives a lot to a marriage and gets very little out of it may continue to do this because of the threat to the personal identity if the process ever stops. There may come a point, of course, at which the terms of trade become too bad altogether and a break-up ensues. This is the "cliff" phenomenon in the legitimacy function. The same thing evidently happened to the monarchy, and it can happen to religion, like the religion of the Aztecs. It could even happen to the national state.

The third source of legitimacy is age. Institutions build up legitimacy just by sticking around, ^{as long as} there is, as it were, an excess of production of it over the consumption of it. Even this function, however, may be non-linear. Up to a point increase in age increases legitimacy; beyond a certain point, however, the senator becomes senile

and the good old things become old-fashioned. One can detect, perhaps, three phases of the function. When things are new, they have the special legitimacy of babies, young people, or the new fashion. At a certain point they become ^{middle aged or} old-fashioned and legitimacy declines sharply. Then as time goes on further they become antiques and legitimacy increases once again. In the case of a creative person, for instance, one often finds a phase of rising legitimacy with age and then a declining phase as he gets out of date, and then an increasing phase as he acquires a posthumous reputation, which is presumably the personal equivalent of being an antique.

The fourth source of legitimacy is mystery. Something which is not understood but which is dimly perceived as obscurely grand and magnificent, acquires an aura of legitimacy in the minds of those who do not understand it. The temples and impressive ceremonies of religion, the "state" of kings, the mystique of the brass hat and the military leader, the sanctity of priesthoods of all kinds and even the mystery of science and the laboratory are all related to this aspect of legitimacy. It depends, of course, on a class structure, on a distinction between the initiates and the common people. Historically it has been a very powerful source of the willingness of the common people to make sacrifices for the benefit of the initiates and to afford them a great deal of legitimacy, often in the absence of much in the way of tangible returns.

Closely related with this aspect of legitimation is ritual or artificial order. Man has always feared the randomness of his environment, the uncertainty of the weather, the crops, of accidental injury or death, of disease, of his whole future state. One of his responses to this has been to create little islands of artificial order, regularly repeated rituals, liturgies and human law. The role which law plays in legitimation is closely related to this aspect of it as ritual. To say that law and ritual are artificial order is not in any sense to deny them validity, nor does it mean that these artificial orders are arbitrary. Where they are successful it is precisely because they reflect an order in the real world, whatever that is. Nonetheless, they are artificial in the sense that they create an island, as it were, of life and experience which is separated from the rest of the world. A monastery is a good example of such artificial order, so is a law court. Insofar as the need for legitimation, as we have seen, is closely related to the need for regularity and for law in the broad sense of regularity and non-randomness, we can easily see why the development of these artificial orders of liturgy and legal procedure, of due process and repeatable and predictable behaviors and decisions are an important aspect in the legitimation process. Here, too, however, we may run into non-linear relationships. Beyond a certain point an artificial order becomes too artificial, and a protest arises against it, and the legitimacy of the institution which is based on it may suddenly collapse. The Reformation, perhaps, may be interpreted as a protest against too

ficial an artificial order in the Catholic Church. The fact that law does not always maintain legitimacy, as the experience of prohibition indicated, also suggests that law too may be "a hass" in the memorable words of some unmemorable character in Dickens, and when it is perceived to be such the legitimacy which is based upon it easily collapses. There are many countries today, indeed, in which law is much less legitimate than it is in the United States, and the legitimacy of law itself is a problem to which we have given far too little attention.

The sixth source of legitimacy consists of the alliance of an institution with other legitimacies. This is what might be called the legitimacy syndrome. If there are institutions which already possess a great deal of legitimacy it is possible sometimes for new and non-legitimate institutions to acquire legitimacy by identifying themselves with the legitimate. It is easy to cite examples of this. The United States built Washington in the fashion of ancient Rome. The United States, being a new and therefore rather illegitimate republic, sought to establish its legitimacy by means of a "tie-in" with Corinthian columns and handsome domes. The legitimacy of the church often permits highly radical and otherwise illegitimate movements to spring up within it, like the Franciscans, or, in our day, the movement of racial equality or even the peace movement. Here again we may run into non-linearities in the relationship. The nouveau riche person who builds a very fancy house may thereby diminish rather than enhance his legitimacy in the eyes

of those he most wishes to impress. A country which wastes its scarce resources on building a vast presidential palace or a grand new capital may not acquire much legitimacy thereby, but only the subtle sneers reserved for unwise decision-makers. One interesting phenomenon here is that the more legitimacy an institution has the less it has to worry about these alliances. In the early days of a university, for instance, it often builds elaborate Gothic or classical buildings to tie in with the legitimacy of the past, and to pretend, as it were, that it has the legitimacy of spurious age. As it acquires genuine legitimacy, however, perhaps in the process of providing payoffs, its buildings become skimpier and more austere, it puts less and less into ritual and into elaborate architecture, until finally it ends up by abandoning gowns, Gothic, ivy, and even grass as it lays down its campus to enormous parking lots.

Let us now apply this analysis as far as we can to the problem of the legitimacy of the banking system, and the central banks in particular. The existence of socialist states shows that this is not an idle problem. Socialism indeed can be interpreted largely as an attack on the legitimacy of certain institutions of exchange and in the socialist states we see the very interesting phenomenon of the gradual reestablishment of many of these same institutions with a different framework of legitimation. In the western world and especially in the United States the legitimacy of the banking system is almost completely taken for granted. It must not be assumed, however, that the banking system or any other institution necessarily creates its own legitimacy, and it

must not be assumed that this legitimacy could never disappear, even though it might seem at the moment to be quite unshakable. The possessors of unshakable legitimacy should always remember Louis XIV at least once a day, even though the Federal Reserve is not the sort of place where heads are likely to roll. It will at least be an interesting exercise therefore to apply the six major sources of legitimacy to the banking system, and see if any dynamic patterns emerge.

The payoffs of the banking system to the rest of society are fairly clearly positive and also are fairly visible. Most people outside the banking system have contact with it either through having a checking account, which is clearly a great convenience, and for which the payment does not seem exorbitant, or through borrowing money, which again we would not do unless we thought that the returns were likely to be greater than the costs. The banking system is perhaps the purest example of an exchange institution. It lives almost entirely by exchange, it does very little physical transformation and the utilities which it creates out of which payoffs to the various parties come are essentially exchange utilities, such as the creation of convenient forms of exchangeables, like checking accounts, or the separation of ownership from control and the placing of asset complexes in the control of those who presumably know how to manage them best. The legitimacy of banking, therefore, falls or rises with the legitimacy of exchange itself.

Even though the payoffs to the banking system for those who deal with it are clearly positive, for it is an essential characteristic

of exchange systems that continued exchange would not take place unless there are positive payoffs to all parties, this is in itself not sufficient to give legitimacy, although it helps. The somewhat loose relationship between payoffs and legitimacy may happen for two reasons. The first, which applies to all exchange institutions, is that an exchange, perhaps because it involves so little in the way of sacrifice, does not generate strong integrative sentiments and feelings. My own bank^{once} advertised as "the bank that puts people first." Everybody knows, however, that this is a ritualistic remark designed solely to create favorable sentiments. If, indeed, I thought it true I probably would not bank there, for what we really want in a bank is that it puts money first, that is, we want extreme probity in accounting, with not a cent out of place, and if this involves some sacrifice of a ^{charming but} careless accountant or a benevolent embezzler I doubt very much if we would fight very much for putting people first. There have been a number of cases, indeed, of benevolent bank officers who embezzled in order to do good, and this is usually frowned upon quite severely. I, at least, want banks to be honest, impeccable and full of rectitude. I do not necessarily want them to be lovable, in spite of some of their advertising. Nevertheless, this absence of lovability in exchange institutions not only seems to worry them a certain amount, it may occasionally lead to their overthrow. Schumpeter, we may recall, argued that capitalism would be overthrown by its very success and because the rationalistic attitude which it generated would destroy the integrative institutions in, say, the family

or the church, or even the state, which enable exchange to be legitimated. Exchange and exchange institutions, in other words, simply pay off too well. They do not demand any sacrifice. Thus an institution which bases its legitimacy on its payoffs may be challenged by another institution which claims to have even better payoffs. This is one reason, perhaps, why legitimacy which is based merely on payoffs is a little insecure, whereas a legitimacy which is based on sacrifice is remarkably stable.

It is at least an amusing fantasy to suppose that we might do a cost-benefit analysis of the financial system, and, indeed, of competing financial systems. The costs, as a matter of fact, are fairly easy to identify. We could, for instance, do a comparative study of, shall we say, Austria and Hungary, two countries at about the same level of development, one of which has a predominantly market-based financial system, whereas the other is a socialist state. We could find out fairly easily the costs of the two systems in terms of resources absorbed into them as of the economy in general. We could find out, for instance, what proportion of the gross national product in each case was absorbed by the financial system. The benefits, of course, would be much harder to assess. Indeed, I would almost despair of ever making a quantitative assessment of them. It is on judgements of this kind, however, that the long-run competition between socialism and capitalism may ultimately be determined.

Merely asking a question of this kind, however, may seem somewhat threatening to the legitimacy of either kind of institution. The legitimacy of the institutions of capitalism could depend a good deal on their simple age, that is, just on the fact that they are not questioned, and that we have got along with them for a long time, with reasonable success. It is one of the curious problems of the dynamics of legitimacy, indeed, that a threat to legitimacy is very hard to counter where the legitimacy itself is a function of age and ritual, for even an attempt to defend a legitimacy of this kind may destroy it. This perhaps is one reason why the Marxist threat to the legitimacy of capitalism was so much more dangerous than would be the case if the legitimacy depended merely on payoffs.

The payoffs to capitalism are actually quite high. A good deal of its legitimacy, however, depended on institutions, like private property, the legitimacy of which had never really been questioned, and rested not on the perception of long-run payoffs at all, but simply on age, long use, and the ritual of law. The legitimacy of socialist institutions likewise depends in good measure on the enormous sacrifices which have been made to create them. The socialist state asks much more fiercely than the late President Kennedy, "Ask not what your country can do for you, ask only what you can do for your country." Because it has demanded enormous sacrifices of its people, in the interests of an ideal, it has become very hard for them to admit that the ideal might not have much in the way of payoffs. Hence the suggestion that the

relative merits of the systems should be tested by cost-benefit analysis would probably even be more threatening to the socialist than it is to the capitalist.

Let us now take a brief look at some of the other sources of legitimacy and see how they apply to the banking system. We have already noticed that banks are not institutions which demand sacrifice, except perhaps sacrifice of temptations to dishonesty and extravagance. Banks, therefore, are not "heroic" institutions and they cannot hope to generate the kind of love and loyalty towards them which such institutions as the church and the national state generate.

The banking system is, relatively speaking, a fairly modern institution. It cannot perhaps draw a great deal of legitimacy from its age, although we do find banks and institutions of all kinds advertising the date of their foundation when that is suitably distant in time as evidence of their integrity, respectability and legitimacy. The Bank of England's affectionate title as "The Old Lady of Threadneedle Street" indicates that age is perhaps not a negligible factor.

The sense of mystery and charisma is also far from a negligible factor in establishing the legitimacy of banks. The bank may not be a heroic institution, but it is certainly mysterious to the ordinary person. Most people even who use banks, and indeed a good many people who operate them, really do not understand the operations of the banking system as a whole. There is, furthermore, a lingering sacred quality about money itself. There is something a little mysterious about the

fact that mere green pieces of paper, or even more remarkable, a signature on a check is sufficient to buy tangible objects of desire. In the past, at least, banks have contributed to the sense of mystery by their very architecture, which has often tended to be quasi-religious. Even if banks shied away from the more subtle mysteries of the Gothic, they have frequently enshrined themselves in pagan temples and Corinthian columns, lofty ceilings, and marble floors, and a general air of hushed ^{which hopefully} magnificence induces in the customer the frame of mind of proper respect and reverence.

Ritual likewise plays a not insignificant role in establishing the legitimacy of banks. Regular hours, standardized procedures, and a highly formalized accounting system contribute to a sense of regularity and order. The banking system, furthermore, is strongly hedged about by legal safeguards and the ritualistic language of contracts. Alliances with other legitimacies are seen not only in the architecture but in the institution of boards of directors, the members of which are usually drawn from other respectable institutions in the community, and also in the institution of the charter granted by the state or by the nation, which brings along with it a certain apparatus of inspection and oversight. We could even regard national deposit insurance, quite apart from its strictly economic aspects, as an alliance with the enormous legitimacy of the national state, for then behind even the most private of banks stands the majesty and legitimacy of government.

We now come rather belatedly to what is supposed to be the main object of this paper, which is the problem of the legitimacy of central banks. Central banking is a rather late development in the banking system. Even in Great Britain the Bank of England did not begin to act as a central bank until well on into the nineteenth century. The United States got along ^{for the most part} without any central bank until 1913, though it had something that might almost be called an informal central banking system before that. Until the establishment of the Federal Reserve System the necessity of central banking was still a matter of debate. The Japanese, for instance, when they began to introduce western institutions began with something like the American national banking system, and only developed a central bank after a number of financial crisis. Today, however, the legitimacy, indeed almost the necessity, of central banking seems unquestioned. Every new country sets up a central bank almost as soon as it is established. It is part of what every well-dressed country will wear.

If we look down our six sources of legitimacy, we will see that almost everything which can be said of the banking system in general applies also to central banks. Here they have unquestionably risen in response to a felt need. There must, therefore, be some kind of a payoff to the organization. These, however, may be of two kinds, market payoffs and political payoffs. The fact that even under a free banking system some strategically located banks tended to perform the functions of a central bank, in that part of their deposits were owned by other

banks and regarded as reserves, suggests that the function of central banking is something which will develop even in a pure market system, simply because there are payoffs for this kind of organization, that is, it can provide adequate terms of trade for all those with whom it exchanges. There are clearly great conveniences, for instance, in the clearing function, in commercial banks holding their reserves in the form of deposits in some central bank, whether this is public or private, and the sheer dynamics of a free financial market would almost certainly throw up the institution of central banking in one form or another.

Without any exception, as far as I know, however, societies have not permitted central banking to grow up simply as a result of market forces, but have always intervened in the matter politically. At some point in the development of the system those who are in control of the legislative process of society perceive certain payoffs in the development of a government central bank which can then be used to control the private banking system. In its political aspects the government central bank can then be seen as a partial movement toward the socialization of the banking system, which leaves the ownership of most of the institutions of the system in private hands, but which uses the government central bank as an instrument of control. This may be regarded for the most part as a problem in the legitimation of power. Because of the very structure of the system, a central bank, whether public or private, will have a great deal of power, that is, the decisions of its responsible decision-makers will have repercussions extending through the

whole system of the society. Power, however, as we have seen, to be exercised continuously must be legitimated, and governmental institutions are the principle agency of legitimation in modern society. Private power will only be tolerated if it is small. This, indeed, is the theory behind the encouragement of competition as a regulating factor, for in a competitive society the power exercised by any particular private decision maker is relatively small and is constantly checked by his competitors. In central banking, however, as in electric power or telephones, there are great advantages of monopoly, which means a concentration of power, and if this concentration is to be legitimated it must be regulated in some way through governmental organization. Hence, it is not surprising to find a strong tendency for government to take over the central banks, even though, as in the case of the Bank of England, nationalization^{may} make practically no difference to its day-to-day operation or even its general policy.

In this picture the Federal Reserve System presents some rather curious anomalies, which may, however, in the American context be more apparent than real. The Federal Reserve System, like the Bank of England before its nationalization, is theoretically privately owned, and is a series of interlocking corporations, theoretically owned and controlled in large measure by the member banks themselves. In reality, of course, the Federal Reserve Banks are public institutions, exercising the great power which they have not to make profit for themselves, but to advance what they conceive to be the public interest. Public

representatives sit on their Boards of Directors and the members of the Board of Governors of the Federal Reserve System are appointed by the President of the United States and confirmed by the Senate. The structure is thus less socialized than that of the post office, more socialized than A. T. & T., though there are certain parallels between the Board of Governors of the Federal Reserve System and a regulatory commission for public utilities.

In the American system of legitimacy these apparent anomalies actually make a good deal of sense, for the American people have a curious ambivalence towards government. On the one hand it is a strong source of legitimacy, on the other hand it is also regarded as something which is always potentially illegitimate and can get out of hand; hence it has to be hedged around with all sorts of constitutional safeguards. The American Constitution can be interpreted in considerable measure as a kind of treaty between a people and its own government regarded as a potential enemy! Consequently, in the United States the government does not have any monopoly of the legitimating process and private institutions, simply because they are private, have a certain legitimacy of their own. It is not surprising, therefore, to find in the United States this curious mix of the public and the private that we find in the Federal Reserve System, and it can certainly be regarded, for its time, an optimum solution for the maximization of legitimacy. Today, certainly, in spite of Representative Patman, there seems to be no major threat within the American system to the legitimacy of the Federal Reserve System, though there have been frequent and perhaps

justified criticisms of its policies. As far as I know, there are no serious proposals either to nationalize the Federal Reserve Banks or to put them under the United States Treasury or to dissolve them and go back to a system of free banking. The principle of separation of powers is still very strong and the notion of the Treasury and the Federal Reserve System as, as it were, two separate fiefs within a broad structure of governmental legitimation does not seem to be seriously threatened.

Most of the other aspects of legitimacy which we noticed as being characteristic of the banking system also apply to the Federal Reserve System. Like the rest of the banking system, Federal Reserve Banks are not heroic institutions, although their association with the national state hangs over them a certain cloak of sacrifice-legitimation, especially insofar as they may have to sacrifice their own ideals of financial probity in times of war. Bankers of all sorts tend to be deflationary rather than inflationary-minded and it must hurt their souls a little to be accomplices in the inflationary financial policy which invariably accompanies a war. This small sacrifice of financial honor, however, is small compared with the sacrifices of the soldier, though it may not be insignificant in contributing to the legitimacy of the institution. Certainly if the central bank were to oppose a war effort on the grounds that it offended their financial principles, their unwillingness to sacrifice their principles would not be taken kindly, and would contribute rapidly toward the loss of their legitimacy.

Central banking is now old enough to acquire a little of the sanctity of age, and it is certainly shrouded in a great deal of mystery

and acquires a certain legitimacy from this fact. Where the ordinary men and the ordinary broker have at least some familiarity with the operations of the member banks, they have no familiarity at all with the operations of the central bank. I must confess myself that I was an economist for thirty years, though not a specialist in money and banking, before I personally set foot within a central bank of any kind, and my knowledge of them and their operations are derived wholly from books and talk. Even in the mind of a professional economist, therefore, the central banks appear as abstractions and cannot be visualized as flesh and blood realities. Whether the central banks should try to enlighten the public and to dispel the mystery is a nice point. It may well be that their own legitimacy is best fostered by preserving a certain air of charismatic obscurity about their operations. Their officers might even take to wearing gowns and robes and their public pronouncements might be couched in even more mysterious and impressive language than they now use.

The concept of a central bank as a creator of artificial order and financial ritual has some interpretive power and should not be dismissed lightly. One of the real problems of central banking policy is that at the heart of it there is a certain arbitrariness. The movements of the bank rate, the decision to change the asset structures, the changes in legal reserve ratios, and other instruments of central bank control have a certain Delphic quality about them. They emerge as the result of arguments which are not disclosed, and yet they have

very powerful effects on the total system. Furthermore, the effects of these decisions are not always easy to trace, and the feedbacks of information are not easy to relate to particular decisions. Under these circumstances the ritualizing of these decisions may be a very important aspect in their legitimation. One might even speculate on the value of ritualizing them more than is now the case. The decisions of a board, for instance, might be entrusted to a dramatically attired rider who would deliver them to the White House with the pounding of hooves and the flourish of trumpets!

We might conclude with a brief look at the possible threats to the legitimacy of the system. The fact that the system survived the Great Depression is a tribute to the remarkable stock of legitimacy which it possessed. The extent to which the Federal Reserve System contributed to the Great Depression is still somewhat a matter of controversy. It certainly cannot be blamed for the whole episode, nonetheless a strong argument can be made that in this period the payoffs of the system for the society as a whole were strongly negative and that disastrous mistakes in policy were made. In the short run, however, as we have noticed the payoffs of the system are only loosely related to its legitimacy and the other sources of legitimacy for the Federal Reserve System are quite strong, strong enough, indeed, to enable it to survive a considerable decline in its payoffs to society. The only source of loss of legitimacy which seems even remotely on the horizon arises out of the sixth factor, that is, the alliances with other legitimacies. The

Federal Reserve System is not allied at all with the legitimacies which derive from religion, from the family, from the arts and from the more poetic, heroic and evocative aspects of life. It is essentially and almost wholly an institution of exchange. Its inputs and outputs are exchangeables, and in itself exchange is too rational an institution to create much loyalty and affection and the kind of legitimacy which proceeds from these sources. I would argue indeed that an exchange institution should not try to derive legitimacy from these other sources, for if it does so it makes itself ridiculous. The Federal Reserve Board should certainly not try to become patron of the arts, an inspirer of heroism or a producer of poetry. To attempt to do so would be like tying peacock feathers on a work horse, and the ridiculous incongruities which would result would lessen rather than enhance the legitimacy of the institution.

Insofar as the legitimacy of the central banks is enhanced by alliances, it is with the national state, and the national state alone. In these days the national state is so fantastically legitimate an institution that it seems almost absurd to suppose that its legitimacy might decline or even collapse. Nevertheless, stranger things have happened. Particularly if the international system deteriorates much beyond its present deplorable condition, the payoffs of the international system for the human race will be so negative that the legitimacy of the national state as the essential and primary institution of the international system will itself be affected. It may be, indeed, that before many decades are up, if we live that long, the national state

itself will have to be desacralized. This, indeed, is what general and complete disarmament and stable peace would involve. To put the matter brutally, some time in the future it may seem as absurd to die for one's country as it would be today to die for the Federal Reserve System.

In the long run, therefore, we may see something very peculiar. It may be the very commonplace and non-heroic aspects of the national state which will save it, and that the strong alliance which exists between central banks and governments may turn out to be a two-way street. At the moment, indeed, it is government that confers legitimacy on central banks to a considerable extent. It is not wholly inconceivable that in the future it will be the fact that the central bank is primarily an agency for human welfare and not for human destruction will confer legitimacy on the government, as we make the subtle transition from the warfare state which threatens to engulf us all in a common destruction to the desacralized commonplace, unheroic welfare state which works simply for human betterment. In the long run I have a good deal of confidence that payoffs in terms of human welfare are the only ultimate and self-sustaining sources of legitimacy. Sacrifice, age, mystery and ritual can fool some of the people some of the time. If, however, they are not associated with real payoffs they will be found out. This of course does not answer the question which we raised earlier as to whether there is not some other form of social organization which has still higher payoffs and lower costs than the existing banking structure. It would be rash indeed to argue that we have exhausted the

potential of social invention in this regard. I am pretty certain, however, that whatever mutation may supplant the existing system has not yet been made, but if the legitimacy of the system rests firmly on its payoffs then the social invention which will supplant it, if it ever comes, should be welcomed with joy rather than fear. It is only what I do not now mind calling the fraudulent legitimacies which fear competition.