
The Case for Free Banking

*H. M. Boot, Senior Lecturer in Economic History at the Australian National University, reviews **The State and the Monetary System** by Kevin Dowd (Philip Allan, London, 1989).*

Perhaps no recent group of writers has had as great an impact upon modern money and banking theory as the free-banking theorists. Two leaders of this group, Lawrence White and Kevin Dowd, have visited Australia in recent years, and made significant contributions to the debate on the role of Australia's own central bank. Both have published extensively on money and banking policy and practice, exposing many of the fallacies and self-serving arguments used by the authorities to justify continued intervention in monetary and banking affairs.

Kevin Dowd's book summarises very succinctly the premises on which the free-banking school's arguments are based, and tackles head-on much of the conventional wisdom used to defend existing institutional structures and practices in modern central banking. The result is a book that is iconoclastic, but truly creative both in its arguments for the need for reform and in providing a coherent agenda for reform.

Although with 194 pages of text the book is quite short, it is full of ideas and information about some of the most profound problems of modern banking. The arguments are tightly expressed and may be difficult for non-specialists, but at no point do they require more than a sound grasp of elementary economic theory. Specialists, on the other hand, will find much to argue with and to use in the further development of the theory.

Three of the seven chapters include long technical appendices. The first four chapters outline the main features of a free-banking system, and enquire into how that system should address the two central problems of central banking: being lender of last resort, and the rules that should govern the issue of currency. Dowd argues that in a free-banking system, where banks are free to issue convertible notes without limit in competition with other banks, competitive market forces will produce a more stable monetary and banking system, and more stable prices and interest rates, than does the present system in which note issue (the monetary base) is controlled by a monopolistic central bank.

An important part of the case for free banking derives from the historical experience of banking under different regulatory regimes, and free-banking advocates tend to draw on economic history more frequently than do other schools of banking and economic theory. Dowd devotes two chapters to the development of central bank theory and practice since the 18th century, and links that practice to some of the major episodes in modern economic history, such as the Depression of the 1930s and the inflation of the last three decades. The history is a little thin in places, and Australian readers would have benefited had the author incorporated Australian experience into the story.

The final chapter offers an agenda for reform of central banking practice along the lines popularised by free bankers over the last ten years. The aim of the reforms is to provide the private sector with a stable monetary environment by depoliticising money and by introducing credible rules to discipline the issue of money. The reforms proposed — the extensive dismantling of existing controls over the monetary system, privatising the central bank, scrapping the central bank's function as lender of last resort, and introducing freedom for private banks to issue their own notes — are, like most of the free-

banking school's proposals, startling at first sight. On the other hand, in spite of the recent trend to deregulation in the Australian monetary environment, there is no doubt that the remaining regulatory structure continues to hamper monetary efficiency and to provide the source of most of our present monetary and banking instability. It is to Dowd's credit, and to that of his free-banking colleagues, that the enormous cost imposed by remaining regulatory constraints continues to be exposed. It is saddening to reflect that whether or not their ideas are adopted, reform will depend less upon the soundness of these ideas than upon how far the existing structure of privileges and political interests that currently surround existing money and banking regimes are threatened.

The Legitimacy of European Settlement

*Rodney Hide, Lecturer in Economics at Lincoln University, reviews **Maori, Pakeha and Democracy** by Richard Mulgan (Oxford University Press, Auckland, 1989).*

Race relations are now a hot topic in New Zealand. The many recent books on the subject offer various treatments of the history of race relations, the justification for the presence of non-Maori in New Zealand, and the case for preferential policies for Maori.

Professor Richard Mulgan's book covers all three areas, but is unique in downplaying the significance of the Treaty of Waitangi. Other writers on race relations build their argument upon the 1840 Treaty, which they think legitimises European occupation while securing resources to Maori that were subsequently unjustly taken. They