

Whether or not governments were needed in the money business, however, they undeniably found getting into it an irresistible source of revenue and power, particularly in time of war or national emergency. Minting coins was easy and profitable. Most convenient of all for a spendthrift king, the coins could be debased—reissued with the same face value but a lesser amount of precious metal—or actually clipped of some of their gold and recirculated. Later, when money developed into a claim on some other asset rather than being intrinsically valuable in itself, governments discovered that they could simply overissue it.

Of course, all this would eventually result in too much money chasing too few goods and rising prices—a process still going on merrily today. But that's in the long run. And in the meantime, monkeying about with money produced interesting spasms in the economy that could be very useful politically—for example, to influence elections.

Market forces can be dammed but not destroyed. By the Middle Ages, even governments that monopolized money found themselves confronted with a burgeoning banking industry that was being summoned into existence by the growth of trade.

Banks not only accepted deposits of money from customers, on which they paid interest, but also made loans to other customers, on which they charged interest. A loan was made by a bookkeeping entry that created a deposit upon which this new debtor could draw. These new banks were able to incur multiple liabilities against the same hard cash, because bank IOUs were exchanged among the public in settlement of their own affairs and rarely presented for payment. In effect, the banks were creating money.



Governments tolerated this development largely because they needed to borrow money themselves, badly. For example, the Bank of England, the ancestor of all central banks, was first granted its charter in 1694 because it promised to buy William III's government bonds and finance his wars when Parliament would not. Similarly in the U.S., the 1863 National Bank Act compelled qualifying banks to hold specified amounts of federal debt, helping to pay for the Civil War.

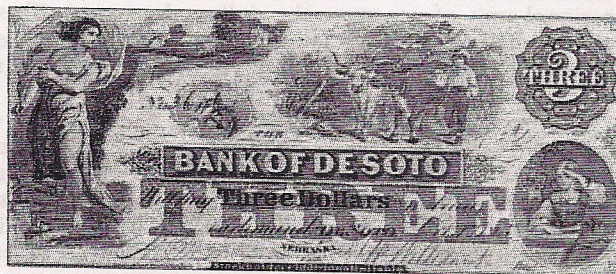
So even a government's monopoly over the issuance of currency gives it only indirect control over the entire

money supply. In recent years in the U.S. this control has been exerted by a straitjacket of banking regulation, much of it dating from the New Deal and subsequently rotted away by inflation, and by the Fed's ability to alter the reserves that banks are required to maintain with it, thus affecting the size of the base upon which they can build their pyramids of credit.

But now "financial innovation" is producing a proliferation of irritatingly hard-to-categorize "near monies"—for example, traveler's checks, some of whose issuers are bound not by reserve regulations but only by their own self-interested prudence. Thus, in a sense, American Express is already issuing its own private money, although denominated in and convertible into Fed-produced dollars.

**H**ayek's proposal is particularly radical because it combines a number of distinct ideas that are already quite radical enough:

- "Free banking"—banks ought to be able to issue currency and create deposits (conceptually the same thing), choose their own reserve ratios and generally operate entirely without regulation.
- Different denominations—privately issued currencies



need not be all denominated in the same unit: Citibank's Wristons and Chase Manhattan's Rockefellers would be traded against each other in a currency market just as the different national currencies are today.

- Private fiat money—these private currencies need not necessarily be convertible into gold or any underlying commodity, but would trade entirely on the word of the issuing bank that it would not debase its money.

*Wouldn't this create chaos? Is Hayek serious?*

Idea number one, free banking, is very serious. New York University's Lawrence H. White has recently attracted much attention with his book *Free Banking in Britain*, a documentation and formal analysis of the system's smooth working over a 128-year period in Scotland. Scottish free banking was suppressed in 1844, not because it didn't work, but in the course of legislation aimed at difficulties in the very different English banking system.

*But didn't this cause chaos in the U.S.? What about the wildcat banks?*

That bit of history is far from settled. Free banking briefly flourished under state charters in the U.S. from 1837 to the Civil War. "Wildcat banks" were accused of locating out in the frontier forests, with the wildcats, so that their notes could not easily be presented for redemption. But recent studies suggest that these problems have been much exaggerated. And most of them, it is argued, were caused by interfering state governments and inadequate enforcement of laws against fraud.

In both Scotland and the U.S. the private money thus issued was denominated in the national monetary unit and was theoretically interchangeable and redeemable into gold. In the U.S., unlike in Scotland, national branch

Courtesy of Stack's Rare Coin Co., N.Y. photos by Steven Brown