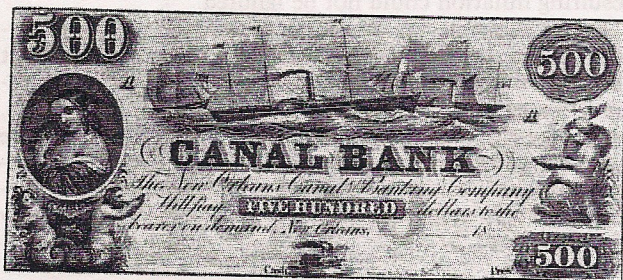


Occasionally, of course, banks and customers would make mistakes. But this should be no more disruptive than a mistake in any other business. Auto factories do overproduce. So do builders of office buildings. But the economy adjusts.

A much-loved answer to the mystery of monetary policy is to link the dollar in some way to gold. But gold standard advocates have always had a problem with gold's moderate but real fluctuations in price (see chart, pp. 244-45), which would inflict involuntary deflations and inflations upon the economy. Competing currencies would tend to solve this problem. Joe Cobb, senior economist for the U.S. Congress' Joint Economic Committee, believes that a private money convertible into gold would eventually become dominant. "But with free banking, other types of money would come in at the margin if there were too little or too much gold-backed money," Cobb says. Silver-backed, maybe, or oil-backed. These monies would either supplement the gold-backed currency (if the gold price had risen, causing deflation) or displace it (if the gold price had fallen, causing inflation).

Recently, the young economists in the private-money subculture have been electrified by hints that the leader of the monetarist school, Milton Friedman himself, is being converted. In 1986 Friedman coauthored a paper significantly softening his view that governments necessarily have a role in money. Even more significantly, he has abandoned his long-held position that the Fed should aim for a fixed rate of growth in the monetary aggregates. Now he argues that the monetary base—Fed deposits plus cur-



rency—should be frozen and complete free banking be allowed to pyramid upon this reserve base.

This looks like a revised monetary rule, but in fact it isn't. Under Friedman's new proposal the free market, rather than the Fed, would dictate the size of the money supply—based on the banks' feel for the legitimate demand for money.

Friedman stoutly denies that his new proposal has anything to do with the volatile velocities of the 1980s, which he blames on Fed policy. Instead, he says he is now convinced that central bankers will never accept moderate restraint, so he proposes to eliminate their power. However, he agrees that under free banking the troublesome issue of velocity would be neatly bypassed.

The proponents of private money take Friedman's shift as confirmation that their position is just the logical extension of market principles. "Once the question is put, there's only one answer," says the University of Sheffield's Kevin Dowd, whose book *The State and the Monetary System* is being published by the Vancouver-based Fraser Institute.

Milton Friedman has an estimate of the chances of money being denationalized: "Zero." But then, he recalls, for years economists were derided for arguing about the feasibility of floating exchange rates. Then suddenly the idea became reality. So, maybe the chances are better than zero.

The first victory of the competing currency school may well be negative. By stressing the fundamental flaws of central banking, they may help derail the diametrically opposed proposal: to develop one world currency centrally managed by the International Monetary Fund. This idea was the subject of a recent cover story in the *Economist* magazine, and a version of it has recently been advocated by Harvard economist and former Carter Administration official Richard Cooper. The single-currency proposal appalls the private-money people, since it would mean an immensely powerful world central bank, able to manipu-



late its money without the minimal discipline existing now because investors can flee into other currencies. The single-currency proposal, says Lawrence H. White, would be "suicide after prolonged self-torture."

It's even possible that competing currencies may come into existence on their own. Richard W. Rahn, chief economist of the U.S. Chamber of Commerce, has actually sketched out a proposal to launch a private currency convertible into commodities or government currencies under prevailing laws. He suggests using commodity futures markets to lower operating costs, and overseas tax havens to avoid the tax problems preventing wider use of the 1977 "gold clause" legislation that made contracts based on gold legally enforceable. "Private money is not just an abstract idea, but an idea whose time has come," Rahn says. "It's technologically and legally feasible."

Meanwhile, a small network of economists attracted by competing currencies is quietly establishing itself. Books and articles are being published, sympathizers located (including outposts in Britain, France and Germany) and eminent authorities intrigued. "It's an intellectually very respectable idea," says Sir Alan Walters of Johns Hopkins University, a leading monetarist and formerly economic adviser to Prime Minister Margaret Thatcher. "I think free banking could work quite well."

*But seriously: Can a handful of thinkers change the world?*

Strange things happen in the idea business. When Adam Smith (who did not regard money as necessarily a government function) wrote *The Wealth of Nations* in 1776, he commented that to expect free trade to be established in Britain was "as absurd as to expect that an Oceana or Utopia should be established in it." But his ideas prevailed in spite of the odds against them, and some 90 years later not one British tariff was left. ■

