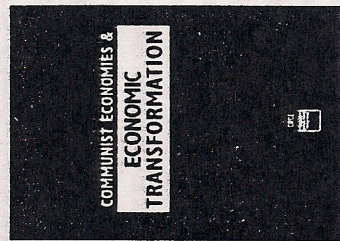


# Communist Economies & Economic Transformation



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Charles A. E. Goodhart

## THE FREE BANKING CHALLENGE TO CENTRAL BANKS

*The numerous historical episodes of free banking have invariably ended in the establishment of central banking. Was the failure of free banking due to "theory," "seigniorage" — the attempt by governments to use central banks for revenue purposes — or to "crises"? Would a free banking system be stable, free of crises? This is the crux of the theoretical and historical debate.*

In 1984 Lawrence White revitalized the free banking school with the publication of his book, *Free Banking in Britain: Theory, Experience and Debate*.<sup>1</sup> This school holds that free competition between commercial banks, unconstrained by the operations, regulation, and supervision of a central bank, or indeed by any special constraints on the business of banking beyond the standard requirements of criminal (e.g. fraud) and commercial (e.g. bankruptcy) laws, provided superior outcomes to those achieved by present monetary systems, managed and regulated by central banks virtually everywhere. White drew on, and extended, the writings and analysis of some doughty earlier advocates of free banking, including such eminent protagonists as Friedrich Hayek,<sup>2</sup> Vera Smith,<sup>3</sup> Walter Bagehot,<sup>4</sup> and Sir Henry Parnell.<sup>5</sup> More recently the free banking approach has been taken up, and moved forward, by a group of

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