Buchbesprechungen

Kevin Dowd: Laissez-faire Banking, Routledge, London and New York 1993, 380 pp.

The present volume contains a collection of essays, the majority of which has already been published before. Their main topics comprise: (1) the evolution of money and banking in the absence of state intervention, (2) the stability properties of a more developed laissez faire monetary system, (3) the historical experience of free banking in Australia, the United States, and elsewhere, (4) the reasons for government intervention in monetary affairs and the actual performance of central banks, and (5) the role of financial deregulation as a remedy for some (if not all) of our current monetary and banking problems.

Under conditions of laissez faire, we are told, the first major intermediate stage of the evolutionary process would be "a highly sophisticated" free banking system (p. 25), characterized by competitive private note issues, convertibility of banknotes into gold, optional clauses (allowing for temporary suspensions of convertibility as in Scotland before 1765), and regular banknote clearings. The final stage is then later described as a "mature free banking system" (p. 68), representing "an indirectly convertible commodity standard" (p. 204), where the gold anchor has been abandoned in favour of a commodity bundle whose relative price to goods in general is reasonably stable, and where banknotes will be redeemed in terms of some medium of redemption like "financial instruments (such as shares)" (p. 257).

A laissez faire system, according to Dowd, is "a very attractive one, far superior to our current monetary systems, which are obviously neither stable nor optimal" (p. 58). Its alleged stability rests on market incentives, private initiative, and competition, or – more specifically – on the working of the clearing mechanism, the convertibility of all private banknotes, and the (supposed) universal recourse to the optional clause. This rather sanguine view is chiefly supported by what the author calls "theoretical" (i.e. more or less plausible) arguments, which are only occasionally supplemented by summary references to some of the historical free banking systems in North America, Europe, and elsewhere.

As far as the empirical evidence is concerned, Dowd summarizes his findings by stating that "genuine (approximately) free banking was apparently always successful, in some cases spectacularly so" (p. 12). This seems to have been the case especially in Scotland, Canada, Sweden, and China (cf. pp. 14, 181, 217), though also the free banking episodes in Australia and the United States are not regarded as a partial or a complete failure. As usual, Scotland receives the highest praise: "The Scottish system in particular was much admired for its stability" (p. 217).

The incentives for state intervention are said to be revenue creation and the stabilization of what is believed an otherwise unstable system. Yet, since "markets work, and governments fail" (p. 204), our present central banks are rigorously blamed for almost all of the monetary evils which the public had to endure during the time of their existence. The Bank of England, for instance, "is damned by its own history" (p. 248), and the Federal Reserve System "consistently pursued its own private interests above everything else, and it played the political game ruthlessly..." (p. 192). These statements, however, are at best suitable for a journalist. They should not be regarded as the result of well-contrived scientific judgement.

Since the mature free banking system is believed to be "optimal by virtually any criterion" (p. 69), the suggested solution for all our current monetary problems is straightforward: the value of the currency has to be pegged to a basket of real commodities, the currency itself has to be made (indirectly) redeemable, and afterwards the financial system must be completely deregulated. These measures would not only be helpful in stopping inflation in Australia (Chap. 13) and in leading us out of the U.S. banking crisis (Chap. 16), but they would also represent a highly desirable alternative to monetary unification along the lines of the Maastricht treaty or of the British Hard-Ecu plan (Chap. 14 and 15).

Dowd, like most proponents of the modern free banking school (e.g. White, Selgin, and Glasner), combines the features of a straightforward economist with those of an enthusiast and a prophet: He indulges in black-and-white depiction, he is mostly prepossessed in favour of the beneficial effects of free competition, he loves to speculate about what would have happened or what would happen if..., he is an unwavering optimist with regard to the practicability of his reform ideas and the smooth functioning of a mature free banking system structured along these lines, and he obviously feels compelled to bring us what we may easily call glad tidings of great joy. In brief: Dowd is a man of strong convictions, a late successor of Martin Luther whose "Hier stehe ich" (cited in the original German) he proudly claims as being also his personal motto (p. 252).

The more sceptical reader might nevertheless doubt the feasibility and the merits of a monetary arrangement, under which competing banks peg the dollar price of a certain commodity bundle, "avoid any physical handling costs by intervening in the futures market to maintain the spot price" (p. 67), and buy dollars back on demand with assets (most probably shares) of the same value as the commodity basket that defined the dollar (p. 257). A question like this one, however, "cannot be resolved by arguing about it in the abstract, because no one has the information needed to predict confidently the relevant gains or losses" (p. 268). If this is – as Dowd maintains – true with respect to monetary unification in Europe, it should also be true with respect to his own case. What is left then, is to stick to the scanty facts.

The only countries with a lengthy and well documented free banking experience are Scotland (1716 - 1844) and Switzerland (1826 - 1907). In Scotland – according to many observers – "the banking system by itself could not contain the excessive note expansion" (Dow, Smithin) until small notes were banned in 1765, and even afterwards, the banks are said to have caused "tremendous commercial revulsions", thereby producing "evils inferior only to those" caused by the banks of the United States (Gouge cited by Mints). Similar views have been expressed by Mushet, Lord Overstone, and Rothbard, indicating that contrary to Dowd's own beliefs the stability properties of a free banking system are still a controversial issue.

The Swiss experience, on the other hand, mostly confirms the prediction of Goodhart (cf. Chap. 10), that competitive pressures would drive private note issuing banks to maintain and expand market shares and that only collusive action would be likely to remedy the ensuing crisis. In Switzerland, even the clearing mechanism – "the most effective check against over-issue" (p. 214) – finally failed, because the public after some time completely ceased to discriminate among banknotes according to the bank of issue (cf. Jöhr). This made it easy for the smaller banks outside the financial centers to enlarge their circulation without losing any reserves, thus pushing the exchange rate of the Swiss franc almost permanently beyond the upper gold point. Relief came only after the majority of issuers had formed a cartell in order to carry out a common discount policy. This cartell, however, proved to be extremely unstable, so that the issuing banks later on unanimously recommended a centralization of the note issue and the foundation of a Swiss National Bank. Dowd, for his part, ignores these facts. In his critical assessment of Goodhart's views he only asks what mechanisms "would induce the banks as a whole to over-expand in this way" (pp. 215/16), although these mechanisms have been amply described by McCulloch and Longfield more than a hundred and fifty years ago.

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