> deposits that once backed the clearing system. All pretext of *regulation* of banks is dismissed.
>
> There are plangent implications for the theory of money and finance. Market yields are determined invariantly against whatever remains of monetary phenomena. Concomitant adoption of [a tabular] standard, explained in Ch. 2, locks in this result. Prof. Knight's Cruosnia plant becomes a quite-plausible generalization of praxis instead of a problematically illuminating phantasy. And the "Wicksell business" crumbles: only real (often implicit) interest rates remain, and are explained by theories of real economic action. Classical economists believed that economics should turn out this way.

Burstein's work reminds one of the Beethoven performances of Toscanini and Schnabel. Not all the t's are crossed, and not all the i's are dotted. But after listening (reading), one never approaches other performances (books) in quite the same way.

Tyler Cowen
George Mason University

The Rationale of Central Banking and the Free Banking Alternative
Vera C. Lutz
Indianapolis: Liberty Press, 1990, 214 pp.

The Rationale of Central Banking was written as a Ph.D. dissertation under Friedrich Hayek at the London School of Economics and first published in 1936. The book covers the development of central banking and the controversies surrounding it in Britain, France, Germany, and the United States. Vera Smith later married the German economist Friedrich Lutz, and the couple moved to the United States just before the outbreak of the Second World War. After the war they settled in Switzerland, and Vera Smith Lutz died there in 1976. *The Rationale of Central Banking* challenged the prevailing view that took the necessity of central banking for granted, and its influence was therefore relatively limited until that conventional wisdom itself began to crack. Economists slowly realized that many of the issues that arise once one ceases to take central banking for granted had already been dealt with by Vera Smith, and her book had a major influence shaping the emerging body of modern free-banking thought in the late 1970s and afterwards. The book has been long out-of-print and difficult to obtain, so the new edition by Liberty classics is very timely and should encourage more people to read it. The new edition has a slightly modified (and, in my opinion, more appropriate) title—*The Rationale of Central Banking and the Free Banking Alternative*—but the text is basically the same. The new version also includes an introduction by Leland Yeager that is a model of clarity, and not only summarizes Vera Smith's life and career, but also provides a concise perspective on the book itself and its place in free-banking thought.

Smith's main theme was a simple one—"A central bank is not a natural product of banking development. It is imposed from outside or comes into being as the result of Government favours" (p. 169). As she wrote several pages earlier, most early central banks "were founded for political reasons connected with the exigencies of State finance, and no economic reason for allowing or disallowing free entry into the note-issuing trade was, or could have been, given at the time" (p. 167). These monopolies became the focus of intense controversy in various countries in the 19th century, but the power of entrenched interests and the influence of dubious economics combined to settle the controversy in favor of monopoly and control, and "thereafter the superiority of central banking over the alternative system became a dogma which . . . was accepted without question or comment in all the later foundations of central banks" (pp. 167–68). Once they were firmly established, these monopolies then acquired the characteristics of our modern central banks. In particular, they came to hold the bulk of the country's specie reserves, and their notes and deposits became a key element in the reserves of the commercial banks. These two factors gave the central bank a unique position of leverage over the rest of the banking system, and the question of how it should use that leverage—the question of central bank policy—dominated the agenda for many decades. Generations of monetary economists consequently wasted their energies on the intractable and insolvable problem of what the monopolist should *do*, and the prior question of whether there should *be* a monopolist in the first place was dismissed out of hand. The central bank's room for maneuver was initially limited by the obligation to redeem its notes and deposits on demand for specie, but this constraint on its freedom to do as it wished (and incidentally, to supply the government with funds) was eventually suppressed by the political authorities so they could squeeze more resources out of the banking system. Convertible money thus gave way to fiat money, and relatively stable prices gave way to inflation.

Vera Smith had the disadvantage of supporting free banking when free banking was widely regarded, to the extent that it was regarded at all, as an anachronistic preserve of the lunatic fringe. It is not surprising, therefore, that she thought that "it is unlikely that the choice [between free and central banking] can ever again become a practical one. To the vast majority of people government interference in matters of banking has become so much an integral part of the accepted institutions that to suggest its abandonment is to invite ridicule. . . . As a matter of practical policy the tendencies are all in the direction of increased centralisation" (p. 195). That that is no longer so, and that the intellectual debate has been more or less won, in the United States at least, is due in no small measure to *The Rationale of Central Banking* and the belated influence it has had. It is a shame Vera Smith did not live to see it.

Kevin Dowd
University of Nottingham