

Preface

For seventeen years, 1968–1985, I worked as an economic adviser on domestic monetary affairs in the Bank of England. For much of that period the main issues on the agenda concerned such topics as the stability and predictability of the demand-for-money function and velocity, and associated questions of the relative merits of alternative monetary targets, rules versus discretion, and the choice between various kinds of monetary control mechanisms.

During the last few years of my stay in the Bank, however, it seemed to me that the focus of interest among academic monetary economists was shifting, away from concern about appropriate rules of conduct for Central Banks, toward even more fundamental issues about the rationale for having such an institution in the first place.

This latter question had last been widely discussed in the nineteenth century, e.g., at the time of the debate between the Banking and Currency Schools and subsequently by Bagehot in the United Kingdom, and had been largely dormant since then. Now, however, there has been a revived interest both in such earlier monetary theorizing and in the earlier historical episodes that might illuminate the question of how successful “free banking,” i.e., in the absence of a Central Bank, might be.

As a monetary historian, I found such revived interest delightful; but as a monetary economist, and an erstwhile Central Bank economist, I found the arguments of those who claimed that Central Banks represented an unnecessary, interventionist, artificial, inflationary intrusion into an otherwise idyllic, efficient, self-equilibrating, natural system of “free banking” to be misconceived.

I set out, therefore, to try to correct the balance, by showing how the role and functions of Central Banks have evolved *naturally* over

time, and play a necessary part within the banking system. In line with much of the recent literature on this subject, I devote a sizable proportion of this book to historical study of the development of Central Banking, but I attempt, in some of the later chapters, to bring the analysis up to date. In fact, there has recently been a proliferation of theoretical advances in our understanding of the nature of banking, and hence of Central Banking.

Like my subject, my own work has evolved over time, rather than conforming to an initially planned structure. It began in the form of a couple of associated private background papers, which I circulated to some colleagues in the Bank. Then, as I began to become more interested in the history and early literature, the essays lengthened, and became festooned with footnotes and appendices. By the time that I left the Bank, the work extended to monograph length, and was published, as such, by the Suntory-Toyota International Centre for Economics and Related Disciplines (ST/ICERD) at the London School of Economics in 1985.

While I felt reasonably content with the historical parts of this monograph, I was concerned that the more theoretical chapters, primarily chapters 3, 6, and 7, needed some further extension and elaboration. In particular, I subsequently wrote another paper on this subject, "Why Do Banks Need a Central Bank?" *Oxford Economic Papers* (March 1987), and I have taken the opportunity of the republication of this monograph by The MIT Press to add additional material from this paper to the present chapter 7 and to reorganize the monograph's structure and form, partly to cut down on its multiplicity of footnotes and appendices.