INTRODUCTION

MONETARY REFORM IN EX-COMMUNIST COUNTRIES

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> Our practical choice is very simple. Either we will be able to create the legal, economic, and financial environment in which private investment will create a young and dynamic economy, or we will have long-term stagnation with a low level of foreign investment, increasing unemployment, social pressure, and the danger of the Weimar syndrome. This is a very serious choice, the outcome of which will be very important for the future of Russia and the whole world.
>
> —Yegor Gaidar[1]

Money in Transition: From Plan to Market

Under central planning and state ownership, money was used as a device to control economic life rather than as a medium of exchange. The state monobank closely monitored the flows of money, goods, and resources to ensure correspondence with planned output targets. In essence, the centrally planned economies of the Soviet Union and Eastern Europe were barter economies in which administrative orders, not market-determined money prices, decided the scope and direction of economic activity. Money was passive; money votes played no active role in guiding resources to satisfy consumers' preferences.[2]

Without private ownership and market prices, including competitive interest rates to determine capital values, all economic decisions,

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[1]Gaidar (1993, p. 5).

[2]For a discussion of the passive nature of money under central planning, see McKinnon (1991, pp. 108–10).

including investment decisions, were necessarily political decisions. The Communist Party's monopoly of power allowed it to determine the criteria for success and failure of state enterprises—and few enterprises were allowed to fail. The absence of bankruptcy, along with an open credit spigot from the state bank for state-owned enterprises, resulted in what Janos Kornai (1986) called a "soft budget constraint" as an inherent feature of socialism.

In sum, the legacy of a centrally planned system of money, credit, and banking is an environment in which (1) money plays no active role in the economy; (2) state-owned enterprises expect automatic access to credit; and (3) banking is noncompetitive, with a dominant monobank acting as the fiscal and monetary agent of the state, monitoring the implementation of planned output targets, and making all the key decisions regarding the allocation of credit. The lack of financial markets means there is no monetary policy as it exists in the West. Statistics on money and credit are well-guarded secrets, and politics, not economics, drives the system of money, banking, and credit.[3]

If ex-communist countries (ECCs) are to make the transition from plan to market, they must overcome the legacy of the centrally planned system of money, credit, and banking that they inherited from former regimes. A dynamic market system depends on sound money and competitive financial markets in which capital is allocated by the forces of demand and supply, as reflected in market interest rates, not by the sluggish hand of state bureaucracy.

The development of markets and a stable monetary order requires both a legal-constitutional transformation and a psychological transformation. Under the old regime, in which the ruling elite dictated political and economic life, there was little respect for the law. People learned to survive by breaking the law and engaging in black-market activities. But if a new regime of private property and free markets is to evolve, individuals must adopt and learn to respect a rule of law that limits the power of government and safeguards individual rights. Constitutional reform is, therefore, an essential component of economic reform.

The adoption of a new constitution, however, will depend on general agreement on a set of principles to be applied across space and time. In addition to accepting the principles of private ownership

[3]For a detailed discussion, see Garvy (1966, chap. 1). According to Garvy (p. 24), under socialism, "the banking system acts merely as a vehicle for the execution of broader government decisions as embodied in the detailed plans; monetary action is not geared to the market but is determined by administrative processes centered on the planned allocation of resources. The familiar tools of monetary policy available to Western central banks are irrelevant."

and freedom of contract, the ECCs must place high priority on the principle of sound money, and that principle must be grounded in an institutional framework that provides for limiting the quantity of money so as to maintain its value. Monetary reform is thus a crucial element in the transition from plan to market.

Monetary instability can undermine the process of privatization and market liberalization. If the state confiscates the money holdings of its citizens or invalidates the purchasing power of money through inflation, those actions increase uncertainty and undermine confidence in any pledge of the government to protect property rights in the future. When the government reneges on its promise to provide a stable-valued currency, respect for law and order declines. That is why Russian reformer Yegor Gaidar (1993, p. 4) has called "the battle against inflation" a top priority in the struggle to create a market order and a civil society.

The question is, How does one move from a system in which central planning has collapsed to a system of private free markets and a sound currency? To answer that question, one must decide on the nature of monetary institutions for the transition period, as well as consider the principles and strategy for achieving long-run monetary stability. The problem is how to make the transition to a stable monetary order and then to maintain that order so that nascent market economies will be able to flourish.

The papers in this issue of the *Cato Journal* address the question of monetary reform in ECCs, both during the transition period and from the perspective of the long-run search for stable money.[4] At the center of that search is the issue of how to depoliticize money and produce a monetary regime that is characterized by credibility, confidence, and choice.

A Stable Monetary Order

The collapse of communism in the Soviet Union and in Eastern and Central Europe opened the door for radical political and economic reform. Entrenched interests have slowed reform, but as the political situation stabilizes and democratic governments emerge from the ashes of socialism, the challenge will be to limit the economic power of government by protecting private property rights and freedom of contract. If elected officials protect inefficient enterprises from

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competition, build a new welfare state on top of the decayed system of central planning, and use the central bank to provide the needed funds, then economic stagnation and monetary chaos will follow.

The only sure way to create political and economic stability in ECCs is to return to a rule of law that protects persons and property and to cultivate monetary institutions that are committed to sound money, so that people have confidence in the future value of money. The problem is how to foster competition so that the state's monopoly power over currency and banking is not absolute.

The solution to monetary instability in ECCs is not to block choice in currencies and in banking but to encourage choice by allowing the use of foreign currencies and by allowing Western banks to compete with their counterparts in the East. The path will then be open for institutional innovation as entrepreneurs learn from their successes and failures.

Credibility, Confidence, and Competition

Instead of seeking aid from international agencies to form a stabilization fund, the ECCs should be thinking of how they can implement and maintain a monetary constitution that severs the link between the fiscal affairs of government and monetary affairs. As long as there is no limit on the monetary powers of government, the state will continue to abuse its privilege of printing money.

Accountability is critical to the search for stable money. If ECCs decide to stay with the status quo of central banking, they will have to set clear rules for monetary policy and determine how to hold monetary authorities accountable for deviations from the long-run goal of price stability.

No matter what set of monetary rules is ultimately chosen in ECCs, the rules will have to be credible if people are to have confidence in them. To maintain a discretionary monetary regime, in which monetary authorities are not bound by any clear principles, would be to go "back to the future." The arbitrariness of decisionmaking and uncertainty about the rules of the game that characterized the old regime should not be perpetuated in a new economic and monetary order.

The new market-liberal order should be built on social and political consensus. Such consensus, argues Vaclav Klaus (1993, p. 527), is "a basic precondition for creating a stable monetary order" and "goes beyond technicalities." In his opinion, "There is no technical, organizational, or institutional device that could potentially make up for the lack of political responsibility, for the lack of political and social consensus, in a country that wants to have a stable monetary order."

People should be free to choose the institutions and the rules they live under. But it may take time for new rules to emerge, that is, for consensus to occur. In the meantime, every effort should be made to avoid excessive increases in the quantity of money and credit, which would fuel inflation and discourage foreign investment.

The case for a monetary constitution is that it would raise the level of credibility so that people would have confidence in the value of money. "It is not enough that prices are stable," writes Antonio Martino (1993, p. 535), "they must also be expected to remain stable." In his view, "The monetary constitution must not be designed for the transition, must not be intended to last only for a limited time, but it must explicitly aim at guaranteeing price stability for an indefinite duration."

Competitive capital markets are essential for a vibrant market system that channels private savings into productive investments and promotes economic growth. Sound financial institutions and a system of competitive private banks widen investment opportunities and consumer choice. But a sound financial and banking network depends, at base, on a strong currency that is readily convertible into both domestic goods and foreign currencies.

The lack of internal and external convertibility of the ruble, for example, has hampered the development of financial markets and discouraged trade and investment in the former Soviet Union. Oleg Bogomolov (1992, p. 368) notes, "The absence of a true monetary system that provides genuine purchasing power that is freely convertible into goods and, later on, into foreign currencies calls into question the entire economic reform." Without stable money and the freedom to trade currencies, the freedom to trade goods will be less valuable.

Monetary competition is important in the transition from plan to market because it provides individuals with the opportunity to shift to a parallel currency if the local currency is unstable. Monetary competition would exert pressure on the domestic central bank to get its house in order. The difficulty is that politicians normally oppose such competition, because they would no longer be able to raise revenue by printing money.

Allowing competition among currencies and among monetary institutions, as proposed by F. A. Hayek (1976, 1978a), would encourage innovation and the emergence of sound money. Institutional choice is an important component of individual freedom, and that freedom will lead to what Douglass North (1992, p. 479) calls "adaptively efficient rules"—that is, rules that "provide

incentives for the acquisition of knowledge and learning, induce innovation, and encourage risk taking and creative activity."

The problem with the Soviet-type economic system was that it could not adapt to change. Individuals were told what to do, rather than allowed to experiment and fail so that errors would not accumulate. In dealing with the problem of transition, therefore, one should keep in mind the need for adaptively efficient rules.[5] And provision should be made for such rules in the monetary regime as well as in other areas of economic, social, and political life. Competition could then work to improve monetary institutions and bring about economic, social, and political order.

The question that transitional economies face is, What can be done to promote credibility, confidence, and competition in the short run while constructing a long-run stable monetary order? William Niskanen (1993, p. 729) writes: "Leaders in ex-communist countries do not have the luxury of an extended academic debate on the issues that bear on the choice among alternative monetary institutions. They must get on with their job under conditions that most of us would regard as chaotic."

As a starting point, ECCs, especially those experiencing or facing hyperinflation (notably Russia and Ukraine) can learn several important lessons from Germany's post–World War I monetary reform.

Lessons from the German Stabilization

Germany's experience with hyperinflation and stabilization in the aftermath of World War I shows: (1) credibility is essential if new policy initiatives are to be successfully implemented and maintained; (2) confidence in the currency depends on a stable-value currency, and such value is best maintained by limiting the quantity of money; (3) competition between the depreciating official currency and a sound parallel currency will speed stabilization; and (4) the money supply must be divorced from the budget—the central bank must not be allowed to monetize government debt as a source of revenue.

Monetary stabilization achieved credibility because Germany's leaders preceded monetary reform with budgetary reform; took responsibility for monetary reform away from the Reichsbank, which had engineered the hyperinflation; and made it clear that the new rules of the game would be enforced. As a result, when the government instituted monetary reform in November 1923,

[5]According to North (1993, p. 21), "The objective of restructuring must be the creation of an adaptively efficient economy—that is, one that over time will provide an institutional framework for a wide menu of alternative choices for organizational innovation and also wipe out failures."

people believed there would be an end to hyperinflation, and that expectation helped minimize the costs of the transition to stable prices without serious, long-lasting effects on employment and output.[6]

The rapid depreciation of the paper mark in the autumn of 1923 led the German government to issue a decree on October 15 that (1) established the Rentenbank; (2) authorized it to issue a parallel currency, the rentenmark, which entered into circulation November 16; and (3) strictly limited the quantity of rentenmarks the new bank could issue. The government promised to redeem rentenmarks for government-backed mortgage securities: for every 500 rentenmarks, an individual could obtain a bond with a nominal value of 500 prewar gold marks. Thus, each rentenmark acquired a value of one gold mark.[7]

Constantino Bresciani-Turroni (1937, p. 348) attributed confidence in the new currency to the fact that the Rentenbank refused to exceed the upper limit placed on the issuance of rentenmarks, even though the government pressured the bank to do so in December 1923. The credible quantity constraint, argued Bresciani-Turroni, gave the rentenmark—which, in fact, was an inconvertible paper currency—a stable value and was "of primary and fundamental importance."

Before the introduction of the rentenmark, there was a "spontaneous reaction of the economic organism against the depreciation of the legal currency" (Bresciani-Turroni 1937, p. 345). As many as 2,000 "emergency monies" had been introduced—some legal, some illegal—in the search for a stable currency to substitute for the rapidly depreciating paper mark. But many of the parallel currencies were unsound, and Germany was in a state of "monetary chaos" (p. 343).

In that climate, the rentenmark, which was a "legal means of payment" but not legal tender, entered into circulation alongside foreign currencies, emergency monies, and paper marks. The new currency tended to drive out the emergency monies and to decrease the velocity of circulation of paper marks. The result was that even though the money supply continued to increase, the rate of inflation began to stabilize. By November 20, 1923, the rate of exchange

[6]For a discussion of these points, see Humphrey (1980, pp. 5–6). He argues that the German experience teaches us that "the task of subduing inflation is easier if the policymakers have established a record of credibility, if they accurately convey their intentions to the public, and if they convince the public of their resolve to stop inflation" (p. 6).

[7]See Bresciani-Turroni (1937, pp. 334–35, 337, 340, 348n).

between the rentenmark and the paper mark settled at one rentenmark for one trillion paper marks.[8]

A further reason for the stabilization was that when the rentenmark first entered into circulation, on November 16, 1923, the government prohibited the Reichsbank from monetizing government debt, thus ending the government's ability to finance its deficits by printing money. The Reichsbank, however, continued to extend commercial credit (Bresciani-Turroni 1937, p. 337).[9]

In October 1924, a new currency, the reichsmark, was introduced to replace the paper mark, and the rentenmark gradually disappeared from circulation. The new legal tender was defined in terms of gold, but convertibility was suspended until April 1930 and then allowed only at the discretion of the Reichsbank (Bresciani-Turroni 1937, pp. 353–54).

The key lesson to be learned from the German monetary reform is that credibility, confidence, and competition are essential ingredients for a successful transition from monetary chaos to monetary order. Monetary stability is most likely to be achieved if there are limits on the quantity of currency and if people are free to choose the soundest currency, so that good money drives out bad or depreciated currency.[10] The challenge for ECCs is to discover the monetary institutions that will best enable them to achieve stable money so that market prices can coordinate economic activity in an efficient manner.

Options for Monetary Reform in ECCs

The papers in this volume consider various options for monetary reform during the transition period and reflect on the principles that should guide the evolution of monetary institutions over time. The options include the use of Eurocurrencies and Western banking services to facilitate international transactions, the adoption of a currency board to issue a parallel currency that would be tied to the dollar or another "hard" currency, the evolution of free banking as a means of providing competition in the issuance of currency to prevent the currency board from acquiring monopoly power, and the use of a

[8]See Bresciani-Turroni (1937, pp. 334–35, 337, 348).

[9]The Reichsbank did not begin to restrict commercial credits until April 1924, because of the danger of creating a severe business depression. The bank's concern over inflationary pressures, however, convinced it to control money growth (Bresciani-Turroni 1937, pp. 351–52).

[10]See Hayek (1976, pp. 18–19, 39–44). According to Bresciani-Turroni (1937, p. 401), "The German example is particularly instructive because it shows that, if the monetary authority . . . does not put some limit to the issues of paper money, prices continue to rise until astronomical figures are reached."

commodity reserve to anchor the value of money (such as a gold-backed ruble) and prevent inflation.

Of course, another option would be to create an independent central bank and limit the quantity of money by a constitutional constraint on money growth or by adopting a nominal GNP target consistent with long-run price stability. Vaclav Klaus (1993, pp. 527–28) prefers "a two-tiered banking system and the independence of the central bank"; and he favors "rules—but rules understood as clear, transparent concepts, not as rigid technical prescriptions." For him, price stability should be the overriding objective of monetary policy.

In principle, all ECCs want to abolish the state monobanks, create a system of private commercial banks, and divorce the central banks from the fiscal arm of government. The problem is figuring out how to depoliticize money and banking. Countries, such as the Czech Republic, that have an institutional memory of Western banking institutions and stable money will find it easier to return to a two-tiered banking system and an independent central bank than will countries, such as Russia, that are confronted with hyperinflation and lack even the remnants of independence and discipline in the conduct of monetary policy. For the latter countries, the immediate need for monetary stability may be better met by looking to options other than the status quo of central banking.

Central banking is neither necessary nor sufficient for stable money and a private, free-market system. What is necessary is a credible commitment to sound money, and that can be achieved by adhering to the "quantity principle" or to the "convertibility principle"—the former would limit the quantity of money or money growth to stabilize the long-run price level, while the latter would provide a spontaneous adjustment of the quantity of money to the demand for money to achieve roughly stable prices over time.[11]

Unfortunately, the history of central banking gives little reason to believe that central banks can provide stable money by adhering to the quantity principle. As Wayne Angell (1993, p. 678) points out:

> History offers a depressing number of examples where discretionary monetary policy has led to disaster. Even in the best of circumstances, fiscal pressures, political considerations in general, as well as genuine uncertainty about what exactly is the best route to take to price stability, conspire to undermine the pursuit of sound money under a managed fiat currency system.

Thus, convertibility and competition appear to offer a more credible institutional framework for insulating money from politics and achieving

[11]For a discussion of the "quantity principle" and the "convertibility principle," see Axel Leijonhufvud (1984, pp. 99–100).

stable money than does central banking, especially in ECCs that have little credibility to begin with.

To break loose from the old state monobanking system, ECCs need a privately run commercial banking system with competitive capital markets, not a governmentally run central banking system that issues fiat money and is not subject to an effective quantity rule.[12] Fortunately, until such a system can be formed, there is a ready-made substitute—namely, the Eurocurrency market and the complementary Western banking institutions.

Adopting Eurocurrencies and Western Banking Practices

A. James Meigs (1993) argues that the most practical way for ECCs to create a stable monetary order during the transition is to allow the use of Eurocurrencies for international transactions and allow Western commercial banks to operate freely in ECCs. The Eurodollar, for example, could be used as a medium of exchange and unit of account for moving goods and capital among the newly formed countries of the former Soviet Union and the newly independent countries of Eastern and Central Europe.

The use of the Eurodollar and other Eurocurrencies would help promote trade relations among the former members of the Council for Mutual Economic Assistance (COMECON) and avoid the call for autarky that normally follows on the heels of domestic monetary uncertainty. The idea is to provide for a parallel currency that would circulate alongside rubles and other ECC currencies and allow the free movement of goods and capital.

Meigs's advice is for governments "to get out of the way and allow entrepreneurs . . . to make their own arrangements" in the Eurocurrency market (p. 725). Moreover, he argues that while latching onto the Eurocurrency market and Western financial expertise, ECCs should remove exchange controls, liberalize trade, permit their currencies to be fully convertible, adopt a floating exchange-rate regime, privatize state enterprises, embark on budgetary reform, and move toward domestic monetary stability.

Instituting a Currency Board

In 1918 and 1919, a currency board, the "Emission Caisse," existed in North Russia. The North Russian caisse issued a fully convertible ruble that circulated alongside the numerous fiat-issued paper rubles in North Russia. Convertibility was maintained, and the new ruble

[12]Paul Volcker (1991, p. 125), former chairman of the Federal Reserve, has written: "I don't think a central bank is essential to a market system historically. What is really essential . . . is a commercial banking system."

issued by the caisse tended to drive the depreciated fiat monies out of the market.[13] Steve Hanke and Kurt Schuler (1993b) think that experiment can be repeated in the new Russian Federation—a parallel currency would eventually put the Russian central bank out of business.[14]

Writing in the *Financial Times*, Hanke and Schuler (1993a) expressed their lack of faith in the ability of the Russian central bank to stabilize the ruble: "As long as Russia has a central bank it is likely to have an inconvertible currency highly prone to inflation. The only way to stabilise the rouble permanently is to change Russia's monetary institutions."[15]

Under the Hanke-Schuler proposal, the Russian currency board would be an autonomous body that would issue a new currency fully backed by a hard currency (probably the dollar) or a commodity basket. If the dollar were the chosen reserve currency, the fate of the new ruble would be in the hands of U.S. monetary authorities rather than in the hands of Russian central bankers. The supply of new rubles would be determined by market forces, and convertibility would ensure that the value of the ruble would be fixed in terms of the dollar. The new ruble would be allowed to float against the old ruble, with the expectation that good money would once again drive bad money out of circulation.

Making the Transition to Free Banking

The currency board can be viewed as a transitional monetary institution, or as a "bridge between central banking and free banking" (Hanke and Schuler 1993b, p. 701). Once the board creates a sound currency, private banks would begin to evolve and to issue their own bank notes, provided there were no legal restrictions. If consumers chose to hold the privately issued bank notes, the currency board would itself go out of business.[16] So while credibility and confidence are essential elements of a stable money regime, the survival of such a regime is best ensured by allowing competition in the supply of currency—or so argues Pedro Schwartz (1993).

According to Schwartz, currency boards should not be given a monopoly on note issue; they should be private, competitive organizations. His strategy for Russia would be "to set up a nonmonopolistic

[13]For a discussion of the North Russian currency board, see Hanke and Schuler (1991, pp. 658–63).

[14]For a detailed discussion of the currency board option for Russia, see Hanke, Jonung, and Schuler (1993).

[15]The same argument is made in Hanke and Walters (1993).

[16]See Hanke and Schuler (1993b, pp. 700–701) and Dowd (1993).

currency board, which could slowly ease itself into the system by the spread of spontaneous acceptance, without the government even noticing what is happening" (Schwartz 1993, p. 625). The new currency "would be a parallel, freely competing currency" and "have no connection whatever with the government and its budget deficit" (p. 630). In time, the currency board might wish to anchor its currency to gold or another commodity rather than to the dollar, which itself has no firm anchor. The private, convertible currency would not be legal tender but would float against the official currency and other privately issued currencies. The free market would determine which currencies survived.[17]

In 1991, Annelise Anderson wrote: "The Soviet Union has done no better at providing people with sound money than it has providing them with food and other consumer goods. Here as elsewhere, a turn to the market would be the best choice." In her present paper, Anderson (1993) explores in detail the case for a "competitive solution" to Russian hyperinflation. Her conclusion is that institutions matter and that competition among monetary institutions is the surest way to produce sound money and banking.

Restoring a Gold-Backed Ruble

During the reign of Peter the Great, a gold coin, the "chervonets" (or "chervonetz") circulated in Russia. The chervonets symbolized sound money, and, in November 1922, V. I. Lenin drew on that symbol to try to stabilize the Soviet ruble, the "sovznak," which was rapidly depreciating. Lenin introduced a parallel currency, which he called the chervonets, and authorized the partial backing of the new currency by precious metals. The chervonets gained credibility and served as a viable substitute for the government-issued fiat money. Gold chervonets coins appeared in 1923 and circulated along with the chervonets notes. In February 1924, the Russian government began circulating another currency, the gold treasury note, which had no fixed relation to gold but was limited in supply. Those reforms helped restore monetary order during Lenin's New Economic Policy.[18]

Restoring a gold-backed ruble as a parallel currency may offer a way to anchor the ruble and help Russia make the transition from plan to market. What Russia needs, writes Oleg Bogomolov (1993, p. 596), is "to create some anchor to stabilize the monetary system and the emerging market economy. A currency parallel to the ruble

[17]See Schwartz (1993, pp. 630–31).

[18]See Hanke, Jonung, and Schuler (1993, pp. 150–55). They write (p. 155): "The chervonets had only moderate credibility, but it was a much more stable and credible currency than the sovznak. It contributed greatly to the revival of the Soviet economy during the period of the New Economic Policy."

(chervonets) with solid commodity backing . . . and freely convertible into foreign currencies might serve as such an anchor."

Alan Reynolds (1993) proposes a real gold standard for Russia. He would make the ruble fully convertible into gold and provide for the circulation of gold coins and gold certificates. Along with free coinage, he would permit free banking. He believes such a system would make the ruble "as good as gold" (p. 675).

Wayne Angell (1993, p. 679) agrees that "it is vitally important that Russia have a sound money right from the start of its transition to a free-market economy." However, instead of the genuine gold standard proposed by Reynolds, Angell favors some flexibility and argues for adopting a "gold price target," which he refers to as an "error-tolerant monetary plan." Under his scheme, the money supply would be allowed to expand if the price of gold fell below the target price, but "the target could be missed if there were a danger of a severe contraction of economic activity" (p. 680). The Russian central bank would not be required to sell gold if the price of gold rose above the target price. Angell recognizes that the introduction of discretion into the monetary regime entails the risk of losing credibility, but he thinks such a scheme is a plausible means of achieving price stability.

The Experimental Method

The free coinage of gold could be combined with free banking to generate a competitive system of money and banking. However, Angell (1993, p. 679) sees such a development as "visionary." In his view, if the economies of Western democracies are not "sophisticated enough in their use of markets and in their acceptance and understanding of competitive forces to rely on free banking and competing currencies," then one should not expect Russia to experiment with "untested economic theory"—especially in light of the failed socialist experiment. Vaclav Klaus (1993, p. 527) is also "not interested in any new social experiments"; he opts to stay with "standard institutional arrangements" for money and banking.

The fact that socialism failed should not prevent experimentation with free-market alternatives to the status quo of central banking and the state's monopoly over the supply of currency. The whole idea of a market-liberal order is to experiment with new institutional rules and to let individuals choose the economic, social, and political arrangements that best protect private property rights and generate wealth. The problem with socialism, as practiced by the Soviet Union and its satellites, was that there was no room for freedom of choice.

All the experiments were conducted by the Communist Party—not for the people, but for the protection of the ruling elite's control over political and economic life.

It takes time to build new monetary institutions, and competition among alternative monetary rules is an important part of the learning process. Free competition should not be confused with socialist experimenting. Consent characterizes the free market, while coercion characterizes central planning. The market's "experimental method" is a discovery process that results in mutual gain;[19] a plan's social engineering is a command process that results in gains to the planners but not necessarily to the people. The search for adaptively efficient rules does not take place under socialism. We should not prevent that search from taking place under capitalism by outlawing free banking and competing currencies.

According to Pedro Schwartz (1993, p. 630), the use of "a freely competing currency board" should be seen "as using the experimental method," rather than "as experimenting" in the socialist sense. Allowing a private parallel currency to compete with the government currency would be one way to test the superiority of a market-based monetary order over a centrally planned monetary order.

Insulating Money from Politics

The search for a stable monetary order, which protects the value of money and encourages a market-liberal order, is a search for a monetary constitution or a set of rules that insulates money from political manipulation, so that the rules are credible and people have confidence in the long-run value of money. The depoliticization of economic life in ECCs must include the depoliticization of money and banking. Competition via the experimental method can help achieve that result and bring about sound money in the process.

In considering options for monetary reform during the transition from plan to market, as well as in considering the monetary framework for the longer run, ECCs should heed Hayek's (1976, p. 16) advice:

> Our only hope for a stable money is indeed now to find a way to protect money from politics. . . . What is so dangerous and ought to

[19]Pedro Schwartz (1993, p. 630) uses the term "experimental method" to distinguish the trial-and-error process of market-based reform measures from planned reform measures that allow no room for choice among alternative institutions. Schwartz's conception of market experimentation is consistent with Hayek's notion of market competition as a method for discovering new information (see Hayek 1978b, chap. 12, "Competition as a Discovery Procedure").

> be done away with is not governments' right to issue money but the *exclusive* right to do so and their power to force people to use it and to accept it at a particular price.

That advice leads one to question the status quo of discretionary central banking and the security of government fiat money.

Klaus's adherence to monetarism is a step toward a nondiscretionary monetary regime with clearly enforced rules to limit money growth, but he fails to take the next step toward the depoliticization of money and banking. The introduction of a parallel currency, issued by a freely competing currency board, would create a competitive monetary regime and pave the way for free banking and privately issued bank notes, which could be backed by gold or a commodity bundle. Those options, including as a first step Meigs's use of Eurocurrencies to help spur international transactions, offer a challenge to the status quo and should help stimulate debate about the future course of monetary institutions in both the East and the West.

The challenge is to remove the obstacles to new monetary arrangements and to let the market process operate so that ECCs can discover adaptively efficient rules. To meet that challenge will require an intellectual revolution in which individuals come to recognize that monetary order, like market order, is best achieved by cultivation rather than centralization—by limiting government rather than extending government.

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