UCO Cahiers de recherche en économie-gestion
N° 2025-eco-15

UCO Working Paper Series in Economics and Business Administration
N° 2025-eco-15

Juillet 2025

Mountifort Longfield's Challenge to Free Banking

Kristoffer Hansen
Universität Leipzig

UCO UNIVERSITÉ CATHOLIQUE DE L'OUEST

EGEI
Éthique et Gouvernance de l'Entreprise et des Institutions

Université catholique de l'Ouest
Faculté de Droit, Économie, Gestion et Science politique
3 place André Leroy, 49008 Angers, France
Responsable : Karl-F. ISRAEL, kisrael@uco.fr
https://recherche.uco.fr/equipe/egei

Mountifort Longfield's Challenge to Free Banking*

ABSTRACT: Vera Smith (1936) called Mountifort Longfield's argument "by far the most important controversial point in the theory of free banking." However, the modern literature on free banking scarcely mentions Longfield, despite his rediscovery or rehabilitation as an important economist and representative of the Irish subjective school (Moss, 1976; Tait, 1982; Rothbard, 1995).

Longfield's argument turn on the effectiveness of interbank clearing in limiting overissue by any one bank. While the modern free-banking school (White, 1984; Selgin, 1988) sees an effective limit on overexpansion in the clearing mechanism (the principle of adverse clearings), as an expanding bank will lose reserves, Longfield (1971 [1840]) argued that this is not so. While the expanding bank will lose reserves as it expands, thereafter a new equilibrium will emerge in interbank clearing. The expanding bank will have a lower reserve ratio, but so will all banks, and the expanding bank will successfully have acquired a larger share of the market.

Longfield's argument concerns a key proposition of the free banking school, namely that there is a sharp limit, in the form of the law of adverse clearings, to overexpansion by any one bank. If Longfield's challenge succeed, then the free banking system falls, but this does not mean that we must accept Longfield's own conclusion to the superiority of a monopoly of the note issue.

While the debates in the 19th century were concerned mainly with note-issuing banks, the principal point is the ability and effects of banks issuing unbacked money substitutes, whatever their form. Longfield's argument will therefore be extended to the case of demand deposits. A free banking system is not safe from the problem of overexpansion, as it is in the interest of every bank to join the expansion once one bank increases its issues, whatever their form.

1 Introduction

In her survey of banking debates in the 19th century, Vera Smith (1936, 88) called Mountifort Longfield's argument "by far the most important controversial point in the theory of free banking."

* Correspondence may be addressed to Dr. Kristoffer Hansen, Institute for Economic Policy, Leipzig University, Germany, or by email: mousten_hansen@wifa.uni-leipzig.de. This paper was presented at the *2ème Journée internationale d'étude en économie politique et philosophie* in April, 2025, at the Université catholique de l'Ouest in Angers, France. The author is grateful for the comments of the participants.

That it escaped his contemporaries is probably due to Longfield's publishing it in the *Dublin University Magazine* in 1840 (Longfield 1971a), rather than in England; and to the fact that, on the surface, Longfield's position looks like standard currency-school theory. Yet despite Smith's high appraisal, later economists and historians of economics have hardly engaged Longfield's argument.

In other points, Longfield's place in the history of economics is well-established. His writings have been collected and published with a scholarly introduction (Longfield 1971b), and he has been the subject of a full-length scholarly biography (Moss 1976; cf. Tait 1982). In surveys of economic thought, his role as part of the early English subjectivist school founded by Richard Whately is recognized (Roncaglia 2005, 229; Rothbard 2006, 2:122–23). However, while Longfield's articles on money and banking are known to historians (Black 1971; Moss 1976, 157–70), they have not shared Smith's judgement of them. Indeed, a recent survey of free banking in the British banking debates makes no mention of Mountifort Longfield (Rallo 2019).

The modern free-banking school pioneered by Lawrence H. White has taken some brief account of Mountifort Longfield. White (1995, 98–102) summarizes Longfield's argument along with those of McCulloch and argues that they rest on an assumption of no note discrimination (which White disputes), and that the process described by them is in any case not cumulative. Summarizing, White (ibid., 102) writes that "[t]he McCulloch-Longfield model was at bottom a model of predatory pricing and no more plausible than any other such model." The other founder of the modern free-banking school George Selgin does not engage Mountifort Longfield directly, but his emphasis on the role of the clearing mechanism in regulating the supply of money (Selgin 1988, 96) implicitly disputes Longfield's argument. Jesús Huerta de Soto (Huerta de Soto 2012, 632–34) cites Longfield as an early critic of free banking, but only to suggest that he and McCulloch led the debate in the false direction, making it about central banking versus free banking. One modern critic of the free-banking school, Manfred Neldner, has however explicitly cited Longfield in support of his own position (Neldner 1996). In one review of a book on free banking, Neldner criticizes the editor (Lawrence White) for disregarding Mountifort Longfield's "remarkable attempt to demonstrate the obvious flaw contained in the argument" and argues that "[t]he theoretical arguments quoted by Vera C. Smith [i.e., Longfield's arguments] and the free banking experience in Switzerland would probably have sufficed to undermine seriously the editor's confidence in the stability of a free banking system in the traditional sense." (Neldner 1995, 407, 411)

Our purpose in this article is to re-examine Mountifort Longfield's argument in light of modern free-banking theory. We will first restate Longfield's position in full and then analyse how it fares against modern free-banking theory. The point is thus not primarily to situate Longfield in the

debates of his own time or to summarize his articles on banking, but to examine his arguments critically and draw out implications, if any there be, for modern debates.

2 Mountifort Longfield's Argument

When Mountifort Longfield wrote on banking in 1840, he did so to support the renewal of the charter of the Bank of Ireland and to propose giving it a monopoly of the note issue in Ireland (Black 1971, 19). Longfield is thus mainly concerned with Irish conditions and writes against various pro-banking pamphleteers, and his policy conclusions are standard for the currency school: monopoly of the note issue and some rule limiting the issue of the Bank of Ireland, though the specific rule he suggests – the Palmer rule – is not the rule eventually adopted in England with Peel's Act in 1844. It is also arguably not strictly compatible with the currency principle (cf. Fetter 1965, 165ff).

In the course of his articles, Longfield develops one particular argument to show that competitive note issue by private banks leads to the inherent instability of the banks and to recurrent crises, as all banks are led into "overtrading". As background, Longfield first lays out the principles that regulate the money supply in a gold standard country, or a country with a mixed currency of gold and redeemable paper (Longfield 1971a, 14–16). When a bank increases its issue, more money enters circulation and the first receivers of money increase their expenditure, until the new banknotes are distributed among the public. The result is a general rise in prices and depreciation of the currency. Since domestic prices rise, exports fall of and imports increase and the balance of trade turns against the country. Gold is consequently exported and the money supply contracts, as the banks of issue have to redeem banknotes for gold. Longfield is here simply developing Hume's classic price-specie flow mechanism, but he does so in explicit contrast to Adam Smith's explanation of the limits to banking (A. Smith 1904, bk. 2, chap. 2). Adam Smith argued that an excess note circulation would be immediately returned to the issuing bank, as the note holders would perceive that their holdings of notes were excessive. According to Longfield, this is not the case, as monetary adjustment goes through the channel of foreign payments.

The delay or time lag in adjustment means that banks of issue can cause inflation and depreciation without themselves facing the full consequences. This is in comparison to a single bank of issue, which will not over-issue, since it itself suffers the consequences:

> When there is a single bank, the consequences of its over-issues fall entirely upon itself, but where there are several banks, the evil consequences of the over-issue of one are partly

> shared among its rivals. Thus the stimulus to overtrading is found to be almost irresistible; while to prevent the mischief likely to ensue from it, demands a degree of tact and skill which is rarely to be found among the managers of a bank. (Longfield 1971a, 33)

Longfield goes on to argue his case with an example (ibid., 34-35). The basic proposition underlying his example is that the issue or circulation of each bank will be proportionate to the amount of business it does. Suppose two banks, A and B, of equal sizes. In monetary equilibrium, each has a circulation of 40,000*l.* and each keeps a reserve of 15,000*l.* in gold. So long as this equilibrium is maintained, each will discount an equal amount of bills and each will be paid fifty percent in its rival's and fifty percent in its own notes. Now suppose that bank A decides to add 20,000*l.* to its discounts, i.e., lend out an additional 20,000*l.* Its issue and the total money supply in the area served by the two banks will increase by that amount. Since the circulation was "full" before this additional issue, i.e., the supply of and demand for money was equal, there is now disequilibrium. On a gold standard, this is cured by an external drain: gold flows out of the country until the money supply has again contracted. In Longfield's example, 20,000*l.* worth of gold will flow abroad. In order for gold to flow abroad, however, banknotes must be presented to the banks and redeemed in gold. However, the public will not demand it all from bank A – they will simply present for redemption whatever notes they possess to fund imports. Since the banks now do business in the ratio of 3:2, this means that 12,000*l.* in gold will flow out of bank A and 8,000*l.* out of bank B.

The money supply thus falls back to a new equilibrium, but the position of the banks will have changed. A now has a circulation of 48,000*l.* and 3,000*l.* in gold reserves, and B will have a circulation of 32,000*l.* and 7,000*l.* in gold reserves. While bank A has a somewhat more precarious reserve position, it has nevertheless expanded its business. The business of the two banks now stands in the relation of 3:2 to each other. Nor is this unstable, since the exchanges between the banks will balance each other. If bank B discounts 10,000*l.* per week, it will receive that sum in payment each week, of which 6,000*l.* will be in its rivals notes and 4,000*l.* in its own notes (since bank A now issues 60 percent and bank B 40 percent of the money supply). Bank A will discount 15,000*l.* per week, since its business is 50 percent larger. Hence, it will receive 9,000*l.* in its own notes and 6,000*l.* in its rival's notes and thus no bank will suffer an outflow of gold.

Longfield concludes that "a bank of issue may have its gold drained off by a rival which, if it has capital enough, may even ruin its competitor, without any injury to itself." (Longfield 1971a, 35) A conservative bank can, faced with this scenario, decide to contract its issues in order to protect its reserves, but this simply enables its rivals to expand more. The conservative bank will also still

suffer a new drain of reserves the next time a rival bank expands its circulation. Thus the forces of competition will push conservative banks to emulate their expanding rivals and take up the “system of over-trading”. A system of private banks all issuing banknotes is therefore inherently unstable and will lead to recurring crises, and a single bank of issue is superior, since it will have no reason to over-issue. Mountifort Longfield’s conclusion is in line with the general trend of the currency school, although no writer of the period seems to have noticed Longfield’s unique argument.

Vera Smith’s Development of Longfield’s Theory

Vera Smith pays ample tribute to Mountifort Longfield in her work on the banking debates of the 19th century, calling his argument the most important controversial point in the theory of free banking (V. C. Smith 1936, 88). Her conclusion (ibid., 178-84) is however somewhat muted, despite her promise when first discussing Longfield to examine his argument at greater length. Smith does not clearly come down for or against argument, perhaps because she considered Ludwig von Mises, citing his *Geldwertstabilisierung und Konjunkturpolitik* (Mises 2006), as the most prominent representative of the free banking school in her own day (V. C. Smith 1936, 178). As a disciple of Friedrich A. von Hayek, a close collaborator of Mises, she may well have shied away from too strong a criticism of a theory she linked closely to Mises.

Another possibility is that Smith thought Longfield’s argument was practically irrelevant. Longfield exclusively discussed note-issuing banks, but by the 1930s banks’ monetary role had been confined to issuing deposits. Smith herself wrote that the distinction between note-issue and deposit-issue was only one of degree, not of kind when considering the possibility of an internal check to credit expansion in a free banking system (V. C. Smith 1936, 182), but in an appendix she appeared to show that overexpansion of one bank was impossible in the case of deposit credit (ibid., 197-200). Hence, Longfield’s argument would appear moot, since it did not apply to deposit credit, the only kind of credit expansion in the modern banking system.

A brief sketch of Smith’s arithmetical example is necessary to evaluate this conclusion. There are two banks, A and B, both doing the same amount of business. In the initial position, each lends 10,000 and 10,000 falling due on each settlement day and each have 40,000 in outstanding notes and 4,000 in gold reserves. A then decides to expand its business by issuing notes, lending 10,000 in extra loans, which fall due four clearing days later. With a few extra assumptions (notably, that the total note issue of A and B remains constant), Smith then runs a brief simulation. At each clearing, A and B receives their own and rival notes in the same proportion as these circulate. At the first clearing this proportion is 5:9 for A’s notes, meaning that B draws gold from A, and in the next two

clearings B also draws gold, although smaller quantities, as the proportion of notes changes in B's favour at each clearing. However, at the fourth clearing, A's new loans come due, meaning that it receives a total of 20,000 against B's 10,000. The result is a large transfer of gold from B to A, reinforcing Mountifort Longfield's view that free banking leads to overissue, since the only way B can protect itself against this large outflow of reserves is if it itself engages in credit expansion.

So much for the note-issuing example. Smith follows up with the case of deposit credit. The facts of the case are otherwise the same, except that checks drawn on deposits are immediately paid into the banks, so the effects of credit expansion appear much sooner. Thus, at the first clearing after A's credit expansion B has a net claim on A of 5,000, which more than exhaust A's gold reserves. Smith ends her example at this point without comment. The implication is that clearing is an effective limit on credit expansion in the case of deposit banking.

Yet is this really the case, or is it not rather an artifact of Smith's artihmetical example? Bank A could, in the deposit case, expand at a slower rate. If, for instance, it only lend out an extra 1,000 (the other assumptions of the example remaining the same), what would be the result?

At the first clearing, B receives a net claim of 500. The position after is 40,500 in deposits for A and 40,500 for B, 3,500 in reserves for A, 4,500 in reserves for B. This exhausts the main reserve loss that A suffers. For the next two clearings, each bank clears 10,000 of loans with the other, and the clearing balance is determined by the proportion of the money supply of each bank's issue. Since each bank has issued 50 percent of the circulating notes at this point, there is no net clearing one way or the other. At the fourth clearing, however, bank A's new loans come due. Bank B still only receives 10,000 in cheques, but bank A receives 11,000. A thus has a net claim of 500 against B, and its reserves grow back to 4,000, while its issue expands to 41,000, while B's reserves fall back to 4,000 and its issue falls to 40,000.

We thus see that Smith's example, even in the deposit case, shows a gain to the expanding bank. Indeed, so long as it can tolerate a temporary reduction in reserves, even the immediate clearing of checks does not check credit expansion. Once all monetary effects have played out, the result is no change in reserves for A and a fall in A's reserve ratio. Bank A has also permanently expanded its business at the expense of bank B, and the clearing situation is once again stable, just as in Mountifort Longfield's original example. Both the business and the note issues of the rival banks now stand in the relation of 41:40. Deposit credit has only slowed, it has not annulled credit expansion.[1]

1 Assuming bank A can go for a time without reserves, the limit to its initial credit expansion is 8,000. At the end of the fourth clearing, it will have deposits of 48,000 and reserves of 4,000.

Our point here is only to show that Smith's example confirms Mountifort Longfield's position. Indeed, the details of her example cause the expanding bank to be in a *better* position. Since Smith only considers clearing, not the external drain as a limiting factor, the expanding bank ultimately not only loses no reserves, it may even gain reserves in the note-issuing case. Smith's argument has, however, been criticized by White (1995, 95). It is not the lag between issue of new loans and receipt of notes in repayment that provides a check on credit expansion, but rather the demand for bank notes on the part of the public. Be that as it may, our point in this section has merely been to show that Smith's (and Longfield's, insofar as Smith follows him) example suggests no clear limit to the issue of notes or deposits on the part of any single bank in the system. We will below examine how well White's arguments fare against Mountifort Longfield's.

3 Mountifort Longfield's Challenge to Free Banking

The modern free banking school has largely ignored Mountifort Longfield. Lawrence White briefly dismisses Longfield's argument as a "model of predatory pricing and no more plausible than any other such model" (White 1995, 102). While Manfred Neldner (Neldner 1992; 1995; 1996) among modern opponents of free banking have cited Mountifort Longfield's argument explicitly, and Vaubel (1977) has pointed to similar arguments, most notably from Otto Neisser (1930), whom Smith also cites, this specific line of argument has not been engaged directly by modern free bankers. Neldner (1996) is sympathetic to Mountifort Longfield, but he regards his as simply a "plausible argument" and does not expand on it at any length. We are therefore forced to attempt a Longfieldian critique of modern free banking theory of our own.

Optimal Reserves and Liquidity Costs

White dismisses Longfield, as we have seen, arguing that his argument only amounts to a case of predatory pricing. A model of predatory pricing is neither in banking nor elsewhere plausible (White 1995, 102). More directly engaging Longfield, White argues that his conclusion rests on the expanding bank being indifferent to its reserves and thus its costs: "neither being a profit maximiser nor having a desired reserve ratio, we should not be surprised that its [the expanding bank's] market share seems indeterminate" (White 1995, 101).

This response to Longfield's argument follows from White's considering reserves determined by the costs of liquidity (White 1995, 4, 7–8). A bank will only expands its issue so long as its marginal revenue exceeds the marginal cost of doing so. However, Longfield and the currency school generally would not accept this understanding of banking "costs". Maintaining the public's trust in

its issue is a key operating cost to White, and liquidity costs are the expenses the bank may eventually bear in the event of an exhaustion of reserves or of a run. These costs, however, are only estimates of bank managers as to what is sound bank policy (cf. Selgin 1988, 94–96). They differ markedly from how costs are estimated in other businesses, or even in the business of minting commodity money. Here, costs mean opportunity costs, or in the frame of classical economics: the costs of production. Longfield and the currency school would argue that the bank is never limited by these, since the costs of actually producing bank notes are negligible, and those of issuing deposits are smaller still. Thus, the banker is at any given point in time not limited by considerations of costs. Rather, what White terms cost ist only the banker's consideration, whether an additional issue, a reduction in his rate of discount, is prudent or not. It is thus, contra White, correct to say that a bank's optimal reserve ratio is undetermined, since the banker can at any point in time choose to lower it. This does not mean that he can immediately lower it to any ratio he likes – we saw from Smith's example that the frequency of clearing acts as a break on too rapid a credit expansion – it means that no matter what his initial position, the banker can always increase his issue.

This view of costs is implicit in the arguments of currency-school and banking-school proponents alike. After all, a general argument in favour of a mixed currency is that it saves on the costs of production of money, since less gold or silver is needed to maintain a given circulation (cf. White 2023). This would only be the case if fiduciary media were less costly or costless, i.e., banks are not faced with the same kind of costs as miners and mints. The merits and potential errors of this view are beyond the scope of this paper, since Mountifort Longfield also subscribed to it (but cf. Hansen 2023 for a critique).

Thus, we cannot really talk about optimal reserves or of liquidity costs, or only in a metaphorical sense. Modern critiques of free banking would here add that the risk of reserve losses are not the kind of risks we can count as costs (Huerta de Soto 2012, 385–95). This is diametrically opposed to free-banking theory, which sees the law of large numbers at work in the actions of depositors and note holders (Selgin 1988, 67). Yet if this were true, banking would be like insurance and not an entrepreneurial activity at all. Only risks that are by definition insurable and can be foreseen can be counted as costs. That is to say, for bank runs to count, we must be able to say that there is x percent risk of a bank run, independent of the actions of the bank or of its customers. The risk must, in Mises's terms (Mises 1998, 106–13), be a kind of class probability. Yet liquidity outflows are not of this kind. Rather, they are a kind of case probability: each bank run is a unique event, caused by the ideas and actions of many freely acting individuals. There are thus no general laws determining the

quantitative risk of a run for all banks, just like there are no laws determining the quantitative probability of profit and loss (Hoppe 2007).

White's critique offers an opportunity to clarify a weak point in Longfield's presentation. Longfield states that an expanding bank could drive its opponents out of business. It is clear that this is not the case, i.e., that an expanding bank cannot immediately do this. However, there is nothing in the banking system to prevent a bank from expanding over and over again. Of course, as its reserve ratio falls, the expanding bank becomes more vulnerable to a run or to some other kind of unforeseen outflow of reserves. The other banks can, it is true, maintain their initial reserve ratio, and will thus lose business. However, since their reserve ratio too is not constrained by costs, they may well look at the expanding bank and conclude that a lower reserve ratio is now optimal. In the course of business, bankers must constantly consider what the optimal level of reserves and the optimal lending policy is. An expanding bank might simply be looked upon as a pioneer, as having discovered that more business can be carried on with a lower reserve ratio. And thus all banks are led, as Longfield argued, into the system of overtrading – not only to protect themselves, but because they have no objective criterion by which they can judge if expansion is sound or unsound, if its a case of sound business or dangerous overexpansion.

Note Discrimination

Mountifort Longfield attacks free banking on another point. The public will, in the event of an overissue, return whatever notes they happen to possess to the banks, they will not discriminate between the notes of expanding and non-expanding banks. If this is so, then Longfield's conclusion follows and the law of adverse clearings will not work against the expanding bank (Neldner 1995, 411). It is however a key tenet of modern free banking that the public discriminates between the notes of different banks (White 1995; Selgin 1988) and that the notes of unsafe banks will circulate at a discount (Selgin and White 1987, 445–46).

This is partly a empirical question, and there is hardly any doubt that the notes of some banks did, at times, circulate below par (White 2003). However, in an established banking system with multiple banks issuing notes or deposits, we cannot assume note brand discrimination. Indeed, as soon as the issue of a bank were discriminated against, its fiduciary media would lose their monetary function and be returned to it. The goodwill of a bank is indivisible, and if it loses it, it will go out of business if not helped by other banks (Mises 1998, 436). A mature banking system will include a clearing mechanism between the banks, and this will tend to reinforce confidence in all participating banks. The note issue of all banks admitted to clearing will tend to be considered

uniform by the public, or in Mises's (1998, 431–37) terminology, the clientele of the separate banks, the people willing to hold their fiduciary media, will be merged and we must then speak of the clientele of the banking system.

Thus, in the situation Mountifort Longfield (1971a) described, it can hardly be the case that note discrimination would limit the overissuing bank. After all, the initial situation was one of several competing banks, the notes of which were all accepted as money. If one bank under these circumstances expands its issue, it will not lead to discrimination against it. After all, its notes were already accepted by the public, and why should this change? Not only may the public be unaware which bank is expanding its issue, even if they notice the inflation, but even if they did, how can they or we judge that the larger issue is not simply the result of the bank being more successful? Note discrimination will only enter the picture when the public loses trust in the bank, when its clientele shrinks and the bank loses its goodwill.

The case of deposits is even clearer. Here, as we saw above, the clearing works more speedily, and circulation is not important, since the deposits are transferred immediately upon spending from one bank to the next. This means that fundamental to a bank's maintaining its goodwill and clientele is admission to interbank clearing (cf. Gertchev 2012). So long as a bank is in the system, however, its deposits are money on par with the deposits of all other banks. It is true that the clearing mechanism gives the banking system as a whole some control over the expanding bank, as we already saw in our discussion of Vera Smith's example above. Ultimately, an unsound bank may be kicked out of the clearing, or it may have to pay a penalty fee for clearing its deposits. Yet while the other banks can restrain an expanding bank, it is not clear why they would. The size and the composition of the money supply will be constantly changing, and as we saw above, it may just be that the expanding bank has found that a lower reserve ratio is workable, in which case the rational response of the other banks will be to follow the expanding bank, not to restrain it. Allowing the expansion by lending the expanding bank the shortfall in clearings is an easy way for other banks to participate and profit from said expansion (Gertchev 2012, 219) in the short term.

Mountifort Longfield's position thus holds up pretty well in this respect as well. He only overstated it: it is unlikely that an expanding bank can really drive its rivals out of business, since the loss of goodwill and the expulsion from clearing will restrain it at some point. But these forces will not prevent a bank from initiating an expansion and profiting from it at the expense of its rivals.

Circulation and Capital

A separate issue that runs through the controversies over free banking from the nineteenth century to the modern day concerns the nature of capital. Mountifort Longfield here only touches on the argument, but it is worth considering it at length. After describing the principle of reflux and citing John Law's argument as to how it will regulate the issue of currency, Longfield concludes:

> The key to the fallacy in the above, and other similar arguments, is, that they confound currency and capital. A man borrows money from a bank, not because there is a deficiency of currency in the country to conduct all the exchanges that take place in it, but because he wants capital to carry on his own business. There is no connection between the two wants. (Longfield 1971a, 108)

This view of the matter was not unique to Longfield, it is pronounced often by currency-school writers. A somewhat late statement of the doctrine is from the sometime governor of the Bank of England, Thomson Hankey (1873, 29):

> Ready money is a most valuable thing, and cannot from its very essence bear interest: every one is therefore constantly endeavouring to make it profitable and at the same time to retain its use as ready money, which is simply impossible. Turn it into whatever shape you please, it can never be made into more real capital than is due to its own intrinsic value, and it is the constant attempt to perform this miracle which leads to all sorts of confusion with respect to credit.

Capital and currency are clearly not the same thing to the Currency School, and a bank of issue cannot create and capital. It was, however, left to Ludwig von Mises, self-conscious an epigone of the Currency School, to flesh out this doctrine. Mises distinguishes two kinds of banking activity: the negotiation of credit and the granting of credit through the issue of fiduciary media (Mises 1953, 261ff.). Banks negotiate credit when they lend other people's money, a definition Mises, citing Bagehot (ibid,. 262) takes over from the Classical School. However, modern banks also grant credit by issuing fiduciary media – historically these kinds of lending were intermingled, but they can be analytically separated. Mises calls the first kind of credit commodity credit and the second kind circulation credit. The crucial distinction to Mises is that while commodity credit means that the creditor must renounce the use of present goods for the duration of the loan, the granting of circulation credit imposes no economic sacrifice (Mises 1953, 265). It is created and granted *ex nihilo*.

Here is not the place to trace out all the implications Mises draws from this distinction, it is enough to stress that he and the Currency School denied that a bank issuing fiduciary media were really adding to the capital stock of a nation. While this point has not been stressed in modern debates, free bankers deny this. Thus, Selgin and White (1987, 443) write: “The lending of depositors’ balances is an innovation that taps a vast new source of loanable funds and alters fundamentally the relationship of the banker to his depositor customers.” And Selgin (1988, 22) argues that, in a fractional-reserve banking system

> every increase in real money demand becomes a source of loanable funds to be invested by banks… Thus, fiduciary issues made in response to demands for increased money balances allow Ruritania to enjoy greater capitalistic production than it could under a pure commodity-money regime.

Naturally, this approach implies a rejection of Mises’s distinction between commodity and circulation credit (cf. Selgin 1988, 61–62). Mountifort Longfield also argued that it implies a misunderstanding of the nature of banking. Banks do not earn profits from extending the circulation, but from interest on the loans they give. That banks extend the circulation is only a means to an end, and it does not lead to a greater supply of capital.

4 Conclusion

Does Mountifort Longfield’s challenge succeed? His arguments did not confront all issues in the controversy, but only those relevant in the Irish debate. However, Longfield highlights a crucial question: is a stable equilibrium possible in banking? His arguments as we have here presented and interpreted them lead us to deny this possibility. He dismissed key arguments put forward by the banking school and its modern epigones, and proposed instead that banking is inherently unstable, that it tends toward the system of overtrading by its very nature.

Free bankers have so far not taken account of Mountifort Longfield’s arguments, nor have their opponents. This is understandable, since Longfield was a minor figure in the controversies of his time once we look beyond the Irish context. A superficial reading would suggest that he was a standard currency-school theorist, but his critique of banking, as Vera Smith noted, makes crucial points against the free banking school. That Longfield himself advocated the standard currency-school solution of a central monopoly of the note issue, and the relative brevity of the core of his critique, disguise the novelty and importance of his argument. Since he, along with the classical economists generally, thought there were real benefits to a mixed circulation, it is understandable

that they were in favour of a monopoly bank of issue. In the context of modern debates, and especially considering the advancements of capital theory, the advantages of a mixed circulation have evaporated.

Mountifort Longfield can also help cast light on historical controversies. Since the origin of the modern free-banking debates in the 1980s, historical examples and above all the example of Scottish banking have played a key role. The mechanism Longfield identified shows why, once free banking becomes widely practised, far from leading to monetary equilibrium, banks will again and again be led into overtrading. However, contrary to Longfield's suggestion, the result is not that one bank will drive its competitors out of business, but that it will lead them on the way of overtrading.

5 Bibliography

Black, R. D. Collison. 1971. 'Introduction'. In *The Economic Writings of Mountifort Longfield*, by Samuel Mountifort Longfield, 5–29. Reprints of Economic Classics. New York: Augustus M. Kelley, Publishers.

Fetter, Frank Whitson. 1965. *Development of British Monetary Orthodoxy, 1797-1875*. Cambridge, Mass.: Harvard University Press. https://archive.org/details/developmentofbri0000fett_j0u3.

Gertchev, Nikolay. 2012. 'The Inter-Bank Market in the Perspective of Fractional Reserve Banking'. In *Theory of Money and Fiduciary Media. Essays in Celebration of the Centennial*, edited by Jörg Guido Hülsmann, 209–28. Auburn, Ala.: Ludwig von Mises Institute.

Hankey, Thomson. 1873. *The Principles of Banking, Its Utility and Economy; with Remarks on the Working and Management of the Bank of England*. 2nd edition. London: Effingham Wilson, Royal Exchange.

Hansen, Kristoffer J. Mousten. 2023. 'Review Essay: Sound Money without Free Banking: Revisiting Economic Principles'. *Quarterly Journal of Austrian Economics* 26 (3): 325–57. https://doi.org/10.35297/qjae.010167.

Hoppe, Hans-Hermann. 2007. 'The Limits of Numerical Probability: Frank H. Knight and Ludwig von Mises and the Frequency Interpretation'. *Quarterly Journal of Austrian Economics* 10 (1): 3–21.

Huerta de Soto, Jesús. 2012. *Money, Bank Credit, and Economic Cycles*. Translated by Melinda A. Stroup. Third edition. Auburn, Ala.: Ludwig von Mises Institute.

Longfield, Samuel Mountifort. 1971a. ‘Banking and Currency’. In *The Economic Writings of Mountifort Longfield*, by Samuel Mountifort Longfield, 5–131. Reprints of Economic Classics. New York: Augustus M. Kelley, Publishers.

———. 1971b. *The Economic Writings of Mountifort Longfield*. Reprints of Economic Classics. New York: Augustus M. Kelley, Publishers.

Mises, Ludwig v. 1953. *The Theory of Money and Credit*. Translated by H. E. Batson. New Haven: Yale University Press.

———. 1998. *Human Action: A Treatise on Economics*. The Scholar’s Edition. Auburn, Ala.: Ludwig von Mises Institute.

———. 2006. *The Causes of the Economic Crisis: And Other Essays before and after the Great Depression*. Edited by Percy L. Greaves. Auburn, Ala.: Ludwig von Mises Institute.

Moss, Laurence S. 1976. *Mountifort Longfield: Ireland’s First Professor of Political Economy.* Ottawa, Ill.: Green Hill Publishers.

Neisser, Hans. 1930. ‘Notenbankfreiheit?’ *Weltwirtschaftliches Archiv* 32:446–61.

Neldner, Manfred. 1992. ‘Review: The Experience of Free Banking’. *Weltwirtschaftliches Archiv* 128 (4): 749–56.

———. 1995. ‘Review: White’s Free Banking’. *Weltwirtschaftliches Archiv* 131 (2): 406–13.

———. 1996. ‘Bankenfreiheit und Noten-Überemission. McCulloch, Longfield, der schweizer Franken die “small note mania” in schottland’. *Schweizerische Zeitschrift für Volkswirtschaft und Statistik* 132 (2): 177–95.

Rallo, Juan Ramón. 2019. ‘The Issue of Free Banking during the Bullionist Controversy’. *Journal of the History of Economic Thought* 41 (1): 99–115. https://doi.org/10.1017/S105383721800041X.

Roncaglia, Alessandro. 2005. *The Wealth of Ideas: A History of Economic Thought*. Cambridge: Cambridge University Press. https://doi.org/10.1017/CBO9780511492341.

Rothbard, Murray N. 2006. *Classical Economics*. Mises Institute edition. Vol. 2. 2 vols. An Austrian Perspective on the History of Economic Thought. Auburn, Ala.: Ludwig von Mises Institute.

Selgin, George A. 1988. *The Theory of Free Banking: Money Supply under Competitive Note Issue*. Totowa, N. J.: Cato Institute ; Rowman & Littlefield.

Selgin, George A., and Lawrence H. White. 1987. ‘The Evolution of a Free Banking System’. *Economic Inquiry* 25 (3): 439–57. https://doi.org/10.1111/j.1465-7295.1987.tb00752.x.

Smith, Adam. 1904. *An Inquiry into the Nature and Causes of the Wealth of Nations*. Edited by Edwin Cannan. 2 vols. London: Methuen & Co., Ltd. https://www.econlib.org/library/Smith/smWN.html.

Smith, Vera C. 1936. *The Rationale of Central Banking and the Free Banking Alternative*. Indianapolis: LibertyPress. https://www.econlib.org/library/LFBooks/SmithV/smvRCB.html.

Tait, Alan A. 1982. ‘Mountifort Longfield 1802-1884: Economist and Lawyer’. *Hermathena* 133:15–28.

Vaubel, Roland. 1977. ‘Free Currency Competition’. *Review of World Economics* 113:435–61. https://doi.org/10.1007/BF02696587.

White, Lawrence H. 1995. *Free Banking in Britain: Theory, Experience, and Debate, 1800-1845*. London: Institute of Economic Affairs. https://iea.org.uk/publications/research/free-banking-in-britain-theory-experience-and-debate-1800-1845.

———. 2003. ‘Accounting for Fractional-Reserve Banknotes and Deposits - or, What’s Twenty Quid to the Bloody Midland Bank?’ *The Independent Review* 7 (3): 423–41.

———. 2023. *Better Money: Gold, Fiat, or Bitcoin?* Cambridge: Cambridge University Press. https://doi.org/10.1017/9781009327466.