

Let People Decide Freely What Money They Want to Use

Johan Norberg, III. ECAEF/CEPROM Conference, Monaco, 5-6 December 2018.

As I was pondering the origin and purpose of money, a friend brought me back to reality. He sent me a message from school about a problem with snack boxes. Apparently, the children had started trading food with one another, and turned school into a wild marketplace. Puffed rice cakes in the boxes created bigger problems than anything else because the children had started using them to pay for other goods, and even to buy help and services.

This school doesn't have a central bank, and yet, the children developed a medium of exchange with all the textbook attributes: It is standardised so that it functions as a unit of account – whereas the fruits they bring vary in quality and size, rice cakes come from the same producer and each unit has the same diameter, weight and taste. And it is a store of value, since it is more durable than perishable fruit. Unlike our fiat money, it is also based on something of real value. If the owner does not want to save for the future, he can always eat his rice cake.

This little story reveals why Carl Menger's theory of the origin of money as an organic process – “Money has not been generated by law. In its origin it is a social, and not a state institution”¹ – is much more realistic than the idea that it started as a government edict. Menger meant that bartering was a hassle since it took a double coincidence of wants. If the baker does not want a copy of my book, I have to find a butcher who does who is willing to exchange it for meat that the baker wants, in order to get my bread. People learn that this hassle is reduced the moment they trade with some good that is in demand by most people. This good eventually becomes money.

This is also the evidence from economic history. Archaeological and historical records show that early civilisations traded with the help of goods like stones, shells, barley, furs and salt. As they became more advanced they began to use precious metals like gold and silver. Puffed rice cakes fits into a long history of economic behaviour.

¹ Carl Menger, *On the Origins of Money*, Ludwig von Mises Institute, 2009, p. 51.

Money is not the creation of governments, but governments eventually nationalised and standardised it, just as it took common law and turned it into a government legal system. Crucially, it banned the use of other media of exchange.² This is not just an issue with theoretical implications, the government initiates force against peaceful individuals to uphold its monopoly. For ten years, Bernard von NotHaus minted and sold coins called Liberty Dollars, made of gold and silver. Because of this he was charged by the US government for federal crimes and “a unique form of domestic terrorism”. In 2014, he was sentenced to six months house arrest with three years probation (the Justice Department wanted 22 years in federal prison).

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As we have learned, through painful experience and economic analysis, monopolies have serious drawbacks and that also applies to the monopoly on money. There are two problems in particular: it makes abuse more likely and innovation less likely.

If people are forced to turn to a particular provider, that provider is not constrained by the discipline of the market. If I am only allowed to buy my clothes from one tailor he does not suffer a loss of market share by offering low quality, high prices and shoddy service. I need clothes, and I am not allowed to turn anywhere else.

This applies to money as well, and not by coincidence. The motive behind government money was not just to standardise it and facilitate trade, but also to create a financial gain for itself by simply creating more money, at a loss to those who already had it. Sweden’s Stockholm Banco is sometimes credited with being the world’s first central bank. It was started by Johan Palmstruch in 1657, who got the charter in exchange for sending half the profits to the crown. It was also the first central bank to debase the currency by printing many more bank notes than it had metal to cover it. The bank collapsed after seven years.

Historically governments have financed its spending and debts by debasing the currency. In the 120 years before the US Federal Reserve was created in 1913, inflation was 8 percent. In the succeeding hundred years, it was 2,300 percent.³

² Murray Rothbard, *What Has Government Done to Our Money?* Ludwig von Mises Institute, 1990.

³ Matt Ridley, *The Evolution of Everything*. Fourth Estate, 2015, p. 297. George Selgin, William Lastrapes & Lawrence H. White, “Has the Fed Been a Failure?” Cato Institute, December 2010.

Making anything mandatory, even best practice, is a way to bloc further progress. We have learned that this is the case in all sorts of markets, because the provision of goods and services have often been freer in another country, so we have learned what could be possible. When it comes to money we have had monopolies everywhere, so we don't know which kinds of innovations we have had to forego. Until now.

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As the great philosopher Leonard Cohen puts it, there is a crack in everything – that's how the light gets in. The digital economy has made it possible to experiment with new media of exchange, at a pace that has made it difficult for the government to keep up with, and we begin to understand that amazing possibilities remain to be explored.

In the early 2000s, researchers found that people in many African countries had started transferring mobile phone minutes to relatives and friends as a medium of exchange. In the absence of a full-service banking system airtime transferred, sold and re-sold turned into a proxy for money. Operators like Safaricom took this idea and introduced software to facilitate all money transfers over cell phones, the so-called M-Pesa. Suddenly Kenya was leading the world in mobile money.

The most revolutionary development is the cryptocurrency, pioneered by bitcoin in 2009, but now followed by more than a thousand other cryptocurrencies. Bitcoin is “mined” (computer processed) by anyone for a declining reward. Its greatest achievement is the distributed ledger, the blockchain, a constantly updated open register that documents transactions without the need for a bank or government to verify it. Whatever happens to bitcoin in the future, this peer-to-peer protocol has the potential to be a platform for countless other ideas and innovations. The simple fact that money can be programmed to come with certain conditions opens up a world of applications. It makes smart contracts possible, self-executing contracts that registers an agreement and enforces it simultaneously, by for example releasing digital cash only if a third party agrees or use bitcoins not just to buy a car, but also to start it.

In both these cases, traditional monetary authorities have fought the newcomers, but also learned from them. Traditional banks are working on mobile money. The Swedish Central Bank has contemplated starting its own cryptocurrency. But that only proves how much innovation we have lost when we blocked competing media of exchange. The M-Pesa was only started because people spontaneously and informally

traded airtime, and the creator of bitcoin has avoided the attention of authorities only because he has remained anonymous.

If we are dissatisfied with the goods, services or media of exchange presently on offer, the best way to replace them is not to force everybody to switch to another version. The information problem that is inherent in the whole human experience and the economy also exists when it comes to money. We don't know what the best currency will be in the future, and what the potential for improvement is.

Brilliant minds have debated whether the best currency is based on a gold standard, a bundle of diverse commodities, the Euro or the Krona, a rule-based fiat money, a cryptocurrency or something else entirely. But there is only one way to find out: a discovery process of innovation and competition, that allows people to start new currencies and choose which one to use.

This is not as far-fetched as it sounds. Before we had the government monopoly, private currencies competed. Wherever governments debase the currency people start using other currencies, often in secret. In many dictatorships people use the US dollar in secret. Saddam Hussein's Iraq used to engrave its dinars in Switzerland, but sanctions forced him to print them back home. The quality of the new bills was poor and the government and other counterfeiters printed too many, resulting in high inflation. However, the old Swiss-engraved dinars were still in circulation, and since they couldn't be printed any more, they seemed more like a store of value, people preferred them and their value began to diverge from the Iraqi dinars.

What these episodes reveal is a kind of reversed Gresham's Law. Just like bad money drive out good money in the same currency, a bad currency drives people towards better currencies. If people have an option, they prefer the currency that retains its value, which does not suffer from inflation, and this puts a limit on how much the government can debase its own currency.

Historically, the argument against competition is inconvenience and chaos, but the digital revolution puts them both in a new light. To begin with the latter, economists fear that free banking would result in overissuance of notes, fraud and bank runs, sparking financial panics. Hayek argued the opposite, the very fact that the issuers

face competition would force them to avoid overissuance.⁴ This is also the evidence from free banking systems in countries like Sweden, Scotland and Canada. Banks that issued too many notes were swiftly disciplined, because of the system of redeemability between banks. Banks knew that they suffered a costly loss of reserves if too many of their notes ended up with rival banks.⁵

These were systems based on gold and silver. Hayek proposed instead competition between private fiat monies. Here the restraint on overissuance would be reputational risk rather than a drain on reserves, and most economists doubt that would be enough. But with digital money this changes, since we can now program algorithms to limit the supply. New bitcoins are being mined for a reward of a certain number of bitcoins, and this value halves for every 210,000 “blocks”, approximately every four years. This means that the total number of bitcoins in existence will probably not exceed 21 million, and puts an upper limit on inflation. Nothing says that this is the optimal system or the optimal number, but issuers who have some algorithmic limitation are likely to drive out those who don't.

The argument about inconvenience traditionally resonates more with the public. How would it work if prices are set in one currency and you have other bills in your pocket? Going to the store would be even more complex than shopping in another currency zone. But credit cards and digital technology has changed this entirely, as we now experience as we travel to other places and the cashier asks us whether we want to pay in our own currency or the local.

Your card or cell phone will be able to pay in any currency and the calculations are done in milliseconds. Every bank, institution or algorithm would be likely to accept most currencies (which are not fraudulent) since this makes their own money more useful, just like banks mutually agreed to accept ATM-cards from other banks.

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Often it is said that competition is good, but that money is too important to be left to the market. But precisely because it is so important and the mishandling of money undermines everything else, we need market discipline and freedom for innovation. We don't know which currency is the best. Let's find out.

⁴ Friedrich Hayek, *Denationalisation of Money : The Argument Refined*. IEA, London, 1990.

⁵ Per Hortlund, *Fribankskolan: Monetär laissez-faire i teori och praktik*. Timbro, 2002. George Selgin, *The Theory of Free Banking*. Rowman & Littlefield, 1988.