The Case for Alternative Currencies: Bitcoin and other phenomena remind us that the Fed shouldn't have a monopoly on money

By Eric Grover

Citi Journal

December 15, 2017

***Money Free and Unfree*, by George Selgin (Cato Institute, 382 pp., $24.95)**

Americans give little thought to how the Federal Reserve exercises monopoly power over the currency supply. One entity issues all American cash, and the greenback is the gold standard, so to speak. Monetary economists, politicians, the media, and the public give little thought to this arrangement. Perhaps it's time that they did.

In *Money Free and Unfree*, George Selgin, director of the Cato Institute's Center for Monetary and Financial Alternatives, provides a relevant—and readable—history of free banking and private monetary systems that have worked in Scotland, Canada, and the U.S. In the eighteenth and nineteenth centuries, Scotland exemplified private monetary arrangements, with specially chartered banks, freely chartered provincial banks, and, by 1810, freely chartered joint-stock banks; in England and Wales, the Bank of England had a monopoly on joint-stock banks. The 1765 Bank Act's imposition of a £500 fine on Scottish banks not immediately redeeming their notes was one of the few restrictions in a light regulatory regime. For a century and a half, Scotland's was the most innovative banking system ever devised. It was also safe: between 1809 and 1835, the bank-failure rate in England was five times that of Scotland. Scottish innovations included branch banking, interbank banknote clearing, interest-bearing deposits, overdrafts, lines of credit, multicolored banknotes, and banknotes printed on both sides. And the Scottish banking system was an early adopter of small-denomination banknotes as a source of financing. No

wonder that Charles Calomiris and Stephen Haber hail this period in Scotland as the golden age of banking.

Throughout the nineteenth century in the United States, state and federal banknotes circulated as money. Banks and bank-owned clearinghouses policed one another, with the notes of riskier or remoter banks trading at a discount. Banks behaved well at the cost of losing their reputation—and the value of their currency—among other banks, clearinghouses, and the public. During the Civil War, the federal government levied a 10 percent tax on state-chartered bank notes, causing most banks to convert to federal charters. Washington mandated that federal banks hold $100 of government bonds for every $90 issued. Until just before World War I, the American economy experienced gentle monetary deflation and suffered a few recessions, but on balance, the economy performed well.

The U.S. established the Federal Reserve System in 1913, and in the century since, the Fed has amassed ever greater power and discretion. Selgin argues that the Fed's record on price stability, economic growth, and economic stability has been worse than predecessor systems. For instance, a basket of consumer goods selling for $100 in 1790 cost $108 in 1913; in 2008, that same basket cost $2,422. "No major institution in the U.S.," Milton Friedman observed, "has so poor a record of performance over so long a period, yet so high a public reputation." The need for a central bank was hotly disputed throughout much of American history. In 1836, Andrew Jackson's administration chose not to renew the charter for the Second Bank of the United States. "Monopoly currency supply is more a cause of, than a cure for, financial fragility," Selgin contends, because the central bank has an incentive to meddle in the economy by debasing the currency. Central banks enjoying a monopoly on currency—and often being the main financial regulator—have a vested interest in the monetary status quo. Moreover, central banks have no natural self-corrective mechanism and are therefore themselves destabilizing.

Selgin's approach to monetary reform is two-pronged. In the short term, he wants central bank power circumscribed. He proposes letting more firms participate in the Fed's open-market operations, through which it buys and sells securities in order to expand or contract the amount of money in the banking system. The Fed can trade Treasury bonds only via its open-

market operations; Selgin urges relaxation of these restrictions, though granting the Fed more discretion to favor certain credit sectors seems to contradict his goal of reducing government influence on money and credit. He recommends reviving the term-auction facility, which essentially allows well-funded banks to borrow money below the official discount rate, in order to make the Fed's supply of credit to banks more efficient. And he suggests eliminating last-resort discount-window lending.

Ultimately, though, Selgin wants to eliminate the Fed itself, and permit private banks to issue asset-backed currency. That's not likely to happen, but even if the central bank endures, he can envision a more competitive system than the one we have now. The Heritage Foundation's Norbert Michel also wants Washington's vise grip on money loosened, recommending that Congress permit competition with the dollar. Michel would amend legal-tender laws so that courts can enforce contractual payment in alternative currency; the IRS can treat alternative currencies as money, rather than assets; and private money would no longer be subject to "know your customer" regulations.

The proliferation of cryptocurrencies today testifies to the demand for monetary alternatives. Bitcoin, Ripple's XRP, and Etherium's Ether command the highest profiles and capitalizations, but more than 900 other currencies exist in cyberspace. In a freer monetary market, banks could issue notes backed by a range of assets, including gold, loans, and Treasury bills. Americans understand that in almost every economic realm, competition produces better results than government monopolies. No Fed economist would recommend that the state should enjoy a monopoly supplying software, credit cards, dentistry, or clothing. A competitive market for money would be more innovative and stable, self-correcting, and consonant with robust growth and price stability.

Eric Grover is Principal at Intrepid Ventures, which provides strategy consulting in the financial-services industry.