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The End of Government Monopoly Money

by Richard W. Rahn

After two centuries of government monopoly money, private monies are re-emerging and will likely come to dominate ultimately. Back in 1976, Nobel Laureate F.A. Hayek published his little classic, "Denationalization of Money." In essence, Hayek argued that money is no different than other commodities, and it would be better supplied by competition among private issuers than by a government monopoly. His book detailed the problems with government monopoly money and how most of these problems could be overcome with private competition.

Even though many agreed with Hayek's argument, it was not clear until now how the government monopoly on money would be broken. As with so many other things, technology has come to the rescue. We are now witnessing the beginnings of the development of practical, private, digital cryptocurrencies, the best known being bitcoin. Bitcoin and most of the other new currencies enable users to make transactions from person to person without going through a bank or other intermediary. This is accomplished through the use of a "blockchain." Before the development of the blockchain, those who had developed cryptocurrencies were not able to solve the double-spending problem to keep people from copying or counterfeiting the digital coin, and the "Byzantine general's problem" of how to keep a malicious party from intercepting and changing the transaction before it reached its intended recipient.

The blockchain, by using what is called a distributed ledger, solved those problems. As a result, developers of cryptocurrencies now have the capability to exchange value in a frictionless way, without regard to national borders, censorship and other laws, or institutions. It re-establishes much of the financial freedom, which has been lost, to the consternation of those who want more government control.

What really frightens the government regulatory class is that blockchains also allow and make unstoppable the development of "smart contracts." A smart contract refers to computer code that will automatically execute contractual duties when a trigger occurs. As an example, if collateral of some sort is kept in a blockchain network, and if the debtor has not paid by a certain date, the computer will automatically transfer the collateral to the creditor, which guarantees certainty of performance. The smart contract can remove all human discretion in the execution and enforcement of contractual duties, and cannot be interfered with by third parties, including officers of court.

Bitcoin is not money in the true sense of the word, because it is only unit of account and a method of exchange, and not a store of value. Combining claims on real assets such as gold, silver, aluminum, wood, wheat, oil and other commodities with blockchains will create true cryptomoney. Some of these are likely to be superior in a number of ways to government monies, particularly those that are afflicted with high rates of inflation or overregulation.

Government officials who are concerned about money laundering and other illegal activities fear the new blockchain cryptocurrencies, because they enable a much higher degree of anonymity than traditional account-based transactions. That, coupled with the near instantaneous settlement of transactions, makes it almost impossible to know who has sent and who has received payment. There is no obvious way for regulators to overcome these problems without destroying the open internet.

At present, the burden of almost all financial regulation, including anti-money laundering requirements, is placed on banks and other financial institutions. They are responsible for "knowing their customer" and the parties to a transaction. If they are suspicious of a transaction, they must report it to government authorities and not execute the transaction. Banks are also required to report all cash deposits and withdrawals above $10,000. The cost, both to the financial institutions and to the government of these tens of millions of reports (almost all of which are on innocent people and transactions) and related regulations, is enormous and places a much bigger relative burden on small financial institutions. This has caused banks to be much more restrictive in allowing people to open bank accounts and for fees to rise to a discouraging level. As a result, many, particularly low-income people, can no longer obtain bank accounts and other bank services and are forced to go elsewhere, often to black markets. The regulations have also slowed down many transactions, particularly foreign ones.

When there is a market need, entrepreneurs always step in to try to solve the problem, either through legal or illegal ways — that is what is driving much of the effort to develop the best cryptocurrency. The energy and the intelligence are on the side of the entrepreneurs, not on the side of the government regulators. Ultimately, government central banks and financial agencies are going to lose this battle. They will be forced to go back to traditional methods of law enforcement that will still enable them to catch bank robbers, kidnappers and terrorists — as they did before 1986 when Congress passed the first anti-money laundering law.

The courts are increasingly ruling that many of the invasive financial and other regulations violate the Fourth Amendment ("against unreasonable searches"). The choice is a world with much greater financial freedom and efficiency as a result of private cryptomoney, or a poorer and more oppressive world.

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