# CURRENCY COMPETITION: SOME OPTIONS CONSIDERED

ANTOINE CLARKE

The benefits of competition in currency provision have been discussed by many authors.[1] There is even a corporatist route for the progressive introduction of formal monetary competition. This consists of the establishment of an independent banking regulator — Ofbank — with a private Bank of England contracted by the government to supply currency.[2] However, pressure on this structure is already foreseeable in the form of Local Exchange Trading Systems (Lets) and in the extension by large retail chains of their "discount card" schemes both of which are outlined in this paper.

The theoretical case for free banking having been established almost *ad nauseam*, a useful exercise is to look at historical cases of private currencies and propose possible vehicles for breaking up the present state monopolist arrangement. Even now there are gaps where market practices can be observed. There are numerous examples of different currencies circulating side by side. Airports, major stores, hotels are already familiar with the concept of accepting payment in a whole array of currencies. In Luxembourg, for example, shops will accept payment in French Francs, Belgian Francs, German Marks, as well as the local currency. Shopkeepers employ cash registers which translate prices according to the currency being used. The same transactions can be found in border towns across the world, with varying levels of technological sophistication.

## GOLD STANDARD

There has been much debate about the desirability of backing currency with tangible assets, such as gold. During the 1970s and early 1980s, the wild fluctuation in the price of gold led to other options being examined.[3] Although recent price fluctuations have not been as dramatic, there are grounds for pessimism about the adoption of gold as the single standard of monetary value.

In the first place the two major producers of gold are South Africa and the former Soviet Union.[4] This concentration of gold production is the reason why there is relative stability in world prices: whenever the price rises a fraction, either the Russian authorities or South African producers unload a large quantity of bullion. The problem with this arrangement is that if gold became the standard of monetary value, Russian and South African producers would have the ability to hold the world economic order to ransom against the threat of major depression or inflation in the world bullion supply. This would seem to defeat the object of having an objective monetary standard.

The second point to consider is the medium to long term stability of the former Soviet Union and of South Africa, both of which offer serious grounds for concern. The effect of a civil war in Russia or South Africa, leaving aside the possibility of both simultaneously, on the price of gold could be as disruptive as the oil crisis of 1973.

## COMMODITY STANDARD

In 1976 Hayek proposed an alternative to gold: the "Commodity Reserve Standard". This would involve banks opening current accounts, issuing notes which would be backed by its own standard, i.e. a "Barclays Pound". These would be redeemed on demand for

**Economic Notes No. 59**

ISSN 0267-7164 ISBN 1 85637 261 8

An occasional publication of the Libertarian Alliance,
25 Chapter Chambers, Esterbrooke Street, London SW1P 4NN
www.libertarian.co.uk email: admin@libertarian.co.uk



Antoine Clarke is a former Economic and Political Adviser to the Finance Minister of the Slovak Republic. He has also worked for the Conservative Party in local government, contested a local election, researched worldwide terrorism and organised crime and written for a variety of publications, in the UK, Slovakia and Spain. He will be completing a Philosophy degree at Birkbeck College, University of London in June 1995. This paper was originally prepared for publication in the 1993 Adam Smith Institute report: *Banking on the Future*.
The author wishes to thank Iain Smedley and Simon McIlwaine for their support.

pounds sterling at a variable rate. At the same time, the bank would regulate the quantity of private currency emission so as to maintain parity with the price of a basket of raw materials at spot prices determined on the international commodity markets.

Forty different quotations of internationally traded raw materials and foodstuffs weighted according to their turnover on world markets would form the basis for the basket. Provided the aggregate value of the basket is unchanged, the weighting could change. There are three broad advantages to the "Commodity Reserve Standard". First, the basket is made up of widely traded commodities sold on regular markets; second, prices on these markets are promptly reported; finally, changes in monetary conditions are reflected more rapidly in raw material prices than in consumer prices. Early corrective action to forestall general price movements is made easier in this way.

Deposits received by the private bank would be invested in highly liquid securities or other assets bringing net real returns or in loans expressed in its own currency. The bank in question would have to be able to accept deposits of any amount of the currencies it was willing to accept. It would also have to be able to redeem on demand any amount likely to be requested, in currencies that would be needed to buy the quantity of commodities which made up the definition of the private currency.[5]

There would be a premium on the selling price of the new currency over its redemption value, reflecting the advantages of extreme stability. Higher yielding accounts could also be introduced offering delayed redemption. The bank would at first maintain a 100 per cent cash reserve of the currencies with which it had undertaken to redeem its own currency. The premiums received would be employed for general business. The premium would increase against currencies which devalued against the private currency.

The real value at which the new currency units were sold would serve as the standard which the issuer would try to keep constant. As demand for the new free-market currency increased, competing enterprises offering similar commodity-linked units would emerge. Any rapid growth in demand could be handled by new competing issuers. Each issuer could employ different standards based on different commodities. For instance, commodities important in one region of the world or of one country might form a greater proportion of the basket than in another regional currency.

It must be remembered that new issuers would have stable assets in terms of loans in their own currency; their own accounts would obviously be kept in terms of that currency. So long as the new issuing institutions remained trustworthy, most of their balances would be used chiefly for transfers from one account to another. Only a small amount need be repaid in terms of Bank of England currency at any time.

Bearing in mind that the crucial factor is the public's willingness to hold a currency, competition between similar institutions issuing commodity-linked currencies would serve to dissuade individual banks from over-issuing their respective currencies. Any additional lending by the banks would therefore need to be based on a corresponding increase in real savings.

The outcome of monetary freedom is not fully predictable. Nothing in the proposals offered here for commodity based monetary standards should be taken as excluding the possibility of other precious commodities being used, either singly or in a basket. Professor Alan Walters has proposed a bimetallic standard. A currency unit would be based on gold and silver, for example in a proportion of one ounce of silver for 0.02 ounces of fine gold.[6]

The ratio would be fixed, but the price would vary for each component of the currency, technical considerations such as the difficulty of creating coins with an alloy of gold and silver would be overcome by using paper. Plastic money, in the form of cards, also renders the problem of mixing alloys redundant. The currency unit in metallic form would be redeemable when the appropriate notes were presented in a bank. The emitters of currency would be obliged therefore to hold sufficient stocks of gold and silver to satisfy demands for convertibility.

## WHY BANKS?

Other companies which have the capacity to experiment with the introduction of private currency are the mass retailers. These offer a wide variety of products, have an extremely high turnover of stocks, are the most secure enterprises in times of economic crisis, and are developing an embryonic financial sector. The Co-op has a bank, most of its competitor stores have charge cards, some will cash cheques, and check-out till technology is ready for private currency. Marks & Spencer plc has a credit rating of "AAA", which is better than many banks. In 1991, M & S made a profit of £11 million for its financial services activities.

Hayek's proposal was for a basket of durable commodities, the price of which would vary individually but provide overall stability. Whereas the discovery of a new supply of gold would cause disruption to monetary stability under the Gold Exchange Standard, a wide spread of perhaps one hundred commodities would not be as easily upset. A supermarket could include in its standard the one hundred products with the highest turnover. Whereas Hayek was looking for durability in his commodity standard, in this case turnover and overall stability of demand would be the guarantors of value.

There are problems for a store like Marks & Spencer offering charge cards which a) pay interest on accounts that are in credit and b) guarantee speedier checkout queues. These are fraud, competition from other stores and restrictions on credit emission. The technology which is used to verify the status of credit cards at present, enables a retailer to know whether the card has been stolen, whether it is genuine, and the basic credit worthiness of the customer. Widespread use of such devices offers the possibility of wider confidence in plastic money.

Already, some stores discriminate in their checkout tills by offering special tills for their own brand of charge card and slower queues for "outsider" cards. Following a Monopolies & Mergers Commission report,[7] ministerial orders have made it legal to offer different prices for cash users and card users. It is also legal to accept certain cards and not others. This offers mass retailers an opportunity to create an alternative to ordinary currency: plastic convertible currency.

## TOKENS ARE CASH

The evolution towards such currencies is plain to see. Already several retail chains have used such devices as "Burger King dollars" as a sales gimmick. Provided that the Bank of England does not have the ability to prevent charge card users from offering preferential prices to cash customers, it is difficult to imagine how the development of this idea, based on examples such as that of the telephone card, could be opposed.

Already one can obtain tokens which may be used to purchase goods and services.[8] The "Air Miles" concept is a perfect example. A supermarket could offer customers a free charge card which can store units of value, known as "Credit Tokens". These would be pegged to a fixed quantity of specific goods and services available at that supermarket. The take-up rate of such schemes could be enormous, given that at least 75 per cent of the UK's population uses one or several supermarkets. Staff are already offered bonus vouchers, redeemable as a discount on goods in the store. In fact, there have certainly been cases where these vouchers were traded by employees — for sterling cash — to non-employees. There is a demand for such a scheme which is partially being satisfied by a "black market".

## LIFESTYLE CHOICE

In an ASI publication,[9] the creation of a private world of personal insurance and social security was expounded. The Friendly Societies were presented as an effective mechanism for voluntary, personal, welfare provision. A certain degree of deregulation of the Friendly Societies would be required to revitalise this market, but mass-retailers could enter in force if the opportunity arose. With a customer base of some 42 million people, supermarkets are in a very strong position to "sell a lifestyle". Car insurance, accident insurance, employment insurance and healthcare insurance could all be provided by supermarkets. The rapid turnover of stocks and good stock management are the keys to successful mass-retail. Both are useful qualities for a nascent financial sector business. The natural resilience of supermarkets during recessions is well documented, and confidence in their viability is generally good.

A supermarket chain therefore has a market on which to launch a private currency and the skills to hold stocks of the appropriate commodities. The added marketing incentive of offering price-stability would only encourage greater stock control efficiency.

Many consumers use several chains on different occasions. Not only is this not a problem, it is an actual incentive to the development of a link service similar to that which exists between many Banks and Building Societies. Private pensions and benefit payment could be made electronically at the check-out till, reducing the administrative cost of such schemes and delivering the benefit where it is likely to be most needed.

In addition to vouchers, some sort of "token credit book" (analogous to a bank cheque book) could be offered to credit-worthy customers. High street banks could generate business by clearing these token credits in much the same way as banks currently offer foreign currency accounts.

## YOU FIRST!

A frequent objection to the introduction of competing currencies is the "access problem", otherwise known as the "you first" phenomenon. People may continue to use a currency which is unsatisfactory, because alternative currencies are not widely accepted. Therefore, banks wishing to issue private currencies would probably wish to employ a similar initial value to pounds sterling and a similar name, so as to allow comparison of its merits to that of the present monopoly currency. Thereafter, a successful private currency could provide a progressively greater incentive to switch from sterling, by not depreciating as quickly as the statist currency.

Another objection levelled at proposals for choice in currency is that the "inconvenience" would outweigh any potential benefits. The economic historian Hugh Rockoff has offered evidence which suggests by analogy that the benefits of a multi-issuer system may in fact outweigh the possible inconvenience to consumers.[10]

## LETS

The ultimate proof of the effectiveness of private currencies is in their establishment without government authorisation and their subsequent expansion, both in quantity of issuers and in quantity of users. This is the experience of the Local Exchange Trading Systems (known as "Lets").[11] The scheme is intended to provide an "alternative" to capitalism. What it actually provides is a network of privately issued currencies.

At present, the Lets system (co-ordinated through "Letslink", the equivalent of a clearing-house), is a non-profit service organised on a local basis. A group of people can set up a Lets by organising a club. Members trade among one another using the currency. Settlements are made through a clearing house, which in some cases publishes accounts of members' transactions, thereby enabling the credit-worthiness of members to be monitored. A directory is issued of members and shops which will accept the regional Lets as part-payment for goods or services.

Because Lets are intended to be non-profit making, overdrafts do not result in interest being charged. However, in a scheme where every members' balance is available for inspection, potential defaulters are spotted at a relatively early stage. The possible deficiency of Lets accounts in terms of credit control are easily remedied: banks wishing to emulate Lets need only impose a premium on convertibility. Despite the imperfect nature of Lets, there having been only eight in April 1991, in February 1992 there were 20, with 12 more being then being established. In April 1993, Letslink claimed 45 member currencies and expected that the number would pass 100 in the course of 1993.

It should be emphasised that Lets cannot be considered to be a fully developed private currency. The adoption of such schemes by "alternative economics" movements based on ecologist groups is not the precedent one would expect the High Street banks to follow. Nonetheless, if Lets can spread at the rate at which they have done since 1991, there is no reason to suppose that more professional commercial enterprises would fail.

One possible course would be for currencies similar in structure to Lets becoming local currencies, with larger currencies such as sterling concentrating on international transactions. The political attraction of such a development would be to separate the fluctuations on foreign exchanges from the day-to-day domestic economic activity.

## POTENTIAL COMPETITION IS COMPETITION

After the lifting of the Bank of England's legal monopoly of currency emission, it is not essential that one or several currencies should appear immediately. The situation where a competitor could enter the market for currency emission but where there are no immediate competitors is not a static position but a dynamic one. The mere possibility of competition would be on the minds of the directors of the Bank of England. Whereas actual competition would be preferable to potential competition, the market pressure to satisfy demand is present in both cases.

In the case of currency emission, a shortage of currency issued by the Bank of England would encourage other financial institutions to emit their own specie, and an over-supplied currency would similarly encourage other banks to issue their own currency, the supply of which they would individually control. In both cases, the Bank of England stands to lose part of its market share. Therefore, preventative action by the directors of the Bank of England can be expected as soon as the end of its monopoly in currency emission is announced. The result would be a dynamic Bank of England, orientated towards satisfying market demands before the onset of new competitors, rather than a crisis-management committee reacting to change, always after the fact.

## NOTES

1. See my bibliography: Antoine Clarke, *The Micropolitics of Free Market Money: A Proposal*, Economic Notes 39, Libertarian Alliance, London, 1992.

   For a comprehensive view of the best material see: Roderick Moore, *Money and How to Privatise It: An Introduction*, Economic Notes 54, Libertarian Alliance, London, 1994.
2. Iain Smedley, "Reforming the Bank of England", in Smedley et al. *Banking on the Future*, Adam Smith Institute, London 1993.
3. F. A. Hayek, *Denationalisation of Money — The Argument Refined (An Analysis of the Theory and Practice of Concurrent Currencies)*, 3rd edition, Hobart Paper Special 70, Institute for Economic Affairs, London, 1990. First edition, 1976.
4. Gold production in metric tonnes for 1990 was respectively: South Africa 603, USA 290, USSR 250. Figures quoted in *Bilan Economique et Social 1991*, published by *Le Monde*, Ivry, France, 1992.
5. The example of Scotland before currency nationalisation in 1845 is worth examining. See Smedley "The history of free banking in Scotland", in Smedley 1993.
6. A. Walters, *Sterling in Danger*, IEA/Fortuna, London 1990, p. 117.
7. Monopolies & Mergers Commission Report: Reference CM 718.
8. Clarke, 1993.
9. T. Evans, *A Friend in Need — based on an idea by Frank Field MP*, ASI, London, 1990.
10. H. Rockoff, "The 'Free Banking Era': a Re-examination", *Journal of Money, Credit & Banking*, May 1974, pp. 144-145.
11. *Daily Telegraph*, Saturday 29 February 1992 (Page III) [Weekend Telegraph Section]. For the record, it is the first article on Lets which anyone on the free-market side brought to my attention, credit for which should go to Michael Johnstone, of Pizarra, Spain.

## SELECT BIBLIOGRAPHY

Kevin Dowd (ed), *The Experience of Free Banking*, Routledge, London, 1992. The best academic study on the subject that I have read.

Friedrich A Hayek, *Denationalisation of Money — The Argument Refined*, third edition, Hobart Paper (Special) 70, Institute of Economic Affairs, London, 1990. The standard text (no pun intended). The argument was refined in the 1980s, with greater emphasis on the "Standard".

Iain Smedley, "The history of free banking in Scotland", in Smedley et al., *Banking on the Future*, Adam Smith Institute, London 1993. The most useful chapter in that report.

Antoine Clarke, *The Micropolitics of Free Market Money: A Proposal*, Economic Notes 39, Libertarian Alliance, London, 1992. Reminds the converted about the existence of doubters.

Roderick Moore, *Money and How to Privatise It: An Introduction*, Economic Notes 54, Libertarian Alliance, London, 1994. Well presented, concise discussion of the more familiar options.