Currency bans benefit bitcoin and the like

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Currency bans occurring in India and Venezuela point to the danger of giving governments monopoly power over the issuance of paper currency.

The lack of choice in currencies— a choice that Nobel economist F. A. Hayek argued is essential to prevent the abuse of power and to combat inflation — deprives individuals of the means to protect themselves from the type of wealth confiscation now taking place in India and Venezuela.

The evolution of private competing currencies, like bitcoin and M Pesa, offer alternatives to government monopoly money, just as email offers a private alternative to the U.S. Postal Service.

Those governments that seek to remove cash will erode trust and speed up the switch to parallel currencies, including cryptocurrencies. Markets expand choices; governments typically narrow them. That is the lesson from the current "war on cash."

When Indian Prime Minister Narendra Modi unexpectedly announced the end of legal tender status for large-denomination notes on Nov. 8, he correctly said that the 500 and 1,000 rupee notes (valued at about $7.50 and $15, respectively) would "become just worthless pieces of paper."
The intended goal of currency removal was to "strengthen the hands of the common man in the fight against corruption, black money and fake currency." But, the unintended consequences have been to increase state power, reduce individual freedom and create widespread chaos and misery.

India is largely a cash society with more than 90 percent of all domestic trade conducted using currency. By denying millions of people the right to use larger- denomination notes in conducting transactions, Modi's "demonetization" has deprived them of an important property right and has inflicted huge costs on "the common man."

In his speech announcing the currency ban, Mr. Modi addressed citizens as "Brothers and Sisters."

"Experience tells us that ordinary citizens are always ready to make sacrifices and face difficulties for the benefit of the nation," Modi said.

Modi called the prohibition on the use of 500 and 1,000 rupee notes a, "festival of credibility." In fact, the shock to economic life for the vast majority of citizens, especially the poor, has led to an increased lack of trust in government.

Although Mr. Modi calls "black money and corruption . . . the biggest obstacles in eradicating poverty," he fails to note that those obstacles stem from an intrusive government that politicizes economic life and encourages rent-seeking behavior — the use of political power to extract favors at the expense of society.

In the 2016 Index of Economic Freedom, published by the Heritage Foundation and the Wall Street Journal, India ranked 123rd out of 186 countries and was classified as "mostly unfree," with a score of 56.2 out of 100.

The intervention of the state in economic affairs resulted in a low ranking for India by Transparency International in its Corruption Perceptions Index. On a scale of 0 (highly corrupt) to 100 (very clean), India scored 38 in 2015 and ranked 76th out of 168 countries and territories.

The insecurity of property rights and overregulation that hinder India's development are being exacerbated by Mr. Modi's edict abruptly depriving people of their freedom to hold 500 and 1,000 rupee notes, which make up 86 percent of the value of India's total cash in circulation.

An unexpected shrinkage of that magnitude can bring the wheels of commerce to a halt and impose serious hardships on an already poor population, especially in towns and villages.

Those citizens who are unable to deposit the banned notes in banks (nearly half of India's population do not have bank accounts), or who cannot exchange them for lower denomination notes, which are in short supply, will be stuck with worthless pieces of paper.

Mr. Modi's currency removal has destroyed wealth and done virtually nothing to end corruption. The rule of law has been further eroded and uncertainty has increased.

The currency crisis gives government bureaucrats an excuse to exercise even more power and to continue rent-seeking activities. The irony is that the Reserve Bank of India is introducing a newly designed 500 rupee note along with a 2,000 rupee note.

Those new notes can then once again be used in the black market, which will not disappear so long as there is no change in economic, legal, and political institutions.

A more extreme example of currency removal or demonetization is taking place in Venezuela under socialist President Nicolas Maduro. His announcement on Dec. 11 that the widely held 100-bolivar note would cease to be legal tender after 72 hours caught people by surprise.

Although the note is only worth two U.S. cents due to the hyperinflation that Maduro has engineered, people use it as a major transaction vehicle.

In announcing the ban, Mr. Maduro stated, "We must keep beating the mafias." With annual inflation exceeding 500 percent and climbing, price controls have caused widespread shortages.

The lack of basic goods is driving Venezuelans to cross the border into Colombia. Border controls have been imposed, but black market activities continue. The removal of 100-bolivar notes is intended to stop the use of black money.

Capital controls have prevented citizens of Venezuela from gaining access to U.S. dollars as a hedge against inflation. There has been a huge loss of wealth as a result of Maduro's draconian economic policies and the chaos created by the currency ban has led to popular uprisings.

Consequently, the ban on 100-bolivar notes has been temporarily lifted. It is due to be reinstated in January along with the introduction of 500, 2,000, and 20,000 bolivar notes. The circulation of those notes, however, will only intensify the hyperinflation.

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