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Local currency is like a car that can't leave town

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How's this for a great idea: we build a small fleet of cars, and market them to people in the local community. How do we compete with Ford, GM, Toyota, and all those other huge car companies? Easy.

You see, our cars will have special octane requirements that will prevent them from refilling at ordinary gas stations. Instead, we'll set up a few local stations that will be the only ones equipped with the right fuel. To top it off (so to speak), our cars will also have small gas tanks to prevent them from reaching the next town on a single tank. (Should we decide to go electric, we can instead equip them with special plugs and voltage requirements to accomplish the same result.)

"Local Exchange Trading Systems" are part of a still larger "local currency" movement.

What all this means is that unlike other cars ours—call them "LETS" for "Local Energy Transportation Systems"—can only be used around town. That way, people who go shopping with them have no choice but to shop locally, and so contribute to boosting the local economy. Who wouldn't want to do that?

The answer, to get serious, is plenty of people wouldn't. Even people who like to buy local don't like having to do so; and the option of driving out of town, whether to shop or for some other reason, is valuable. So a car that can go anywhere is worth more — for many a lot more — than one that can't, which means that so long as Ford or Toyota or any other manufacturer can make a decent "national" car for no less than what the local alternative would cost, we'd better leave making cars to them.

Such reasoning presumably explains why there's no such thing as a Local Energy Transportation System aimed at challenging existing car makers. Yet there is such a thing as LETS: it stands for "Local Exchange Trading System," and there are now several hundred such systems in operation around the world. LETS are part of a still larger "local currency" movement.

Like the fictional LETS we were just toying with, actual LETS and other local currency arrangements are designed to encourage people to shop locally.

The **UK LETS website**, for example, boasts that, unlike ordinary money which "is quickly sucked out of the area where it has been created", LETS "stays local, benefiting the community, rather than outside-interests." The schemes' promoters see to it that their currency won't "leak out" of the local economy by encouraging local merchants and banks to accept it, while scrupulously refraining from encouraging "outsiders" from doing so. In short, they make a virtue of their currencies' limited usefulness — of the fact that, unlike most exchange media, they are not generally accepted.

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This strategy ought to make local currencies about as desirable as cars that can only run on local gas. Yet (if **Wikipedia's** experts can be trusted) there are some 2,500 such local currency schemes afloat, with new ones popping up all the time.

So are monetary economists wrong in supposing that to be any good, money has to be generally acceptable? They aren't, and the proof is that the 2,500 local currency systems collectively represent an insignificant part of the world money stock, and that the vast majority of such schemes that manage to get off the ground collapse after a few years, if not sooner.

As for the few that have lasted longer, almost all are, by no coincidence, located in (mostly "liberal") communities where strong "buy local" sentiments prevail. This means that there are relatively large numbers of people who feel good about shopping locally, for whom the opportunity cost of employing a strictly local currency is relatively small. For such consumers using local currency is like clipping coupons for stuff one plans to buy anyway.

As for the banks that agree to accept local currency, most do so solely for public relations reasons and despite the fact that local currency dealings eat into their profits, as is evident from the general reluctance of banks with large out-of-town networks to participate.

More importantly, the object that the local currency movement would achieve if it could — that of "keeping trade within the community" – is, like all forms of protectionism, **a highly dubious one**.

As **Tim Harford** succinctly puts it, "the gains from more trade with locals are more than offset by the losses from less trade with strangers. Otherwise economic sanctions would be a blessing." (Try telling a Palestinian or Cuban about the virtues of "buying local"!)

Besides constraining people to buy locally, many local currencies are designed to yield "negative" interest, by losing value relative to national money according to a fixed schedule, or by expiring entirely after a certain period, or both.

The further back one goes the less onerous local currency becomes since people travelled less.

The idea here — one first popularised in the 1930s by **Silvio Gesell** — is to discourage people from holding on to local money, thereby increasing its velocity, so that a given quantity results in that much greater a boost to local spending. Here again the aim of boosting local spending is at loggerheads with that of making local currency an attractive substitute for national currency. To

return to the “local car” analogy, it would be like saying to a prospective car buyer, “Look, our cars’ bodies rot fast, so you’ll have to go shopping more often to get your money’s worth!”

This isn’t to say that local currency can never serve any purpose apart from that of allowing some people to better display their kind disposition toward local merchants and producers (or, perhaps, their poor understanding of basic economics).

Historically, **local currencies have played a crucial role in sustaining exchange when national alternatives were in short supply**, as happened during the Great Depression (when in many communities “**scrip**” made up for vanished or inaccessible bank deposits), and as happened in late 18th-century England (when**private mints and coin issuers** made up for a dearth of official small change). Despite its inconvenience local money is of course better than no money at all; besides, the further back one goes the less onerous local currency becomes, since people travelled less anyway.

Though the shortcomings of local currency are serious ones, they are far from being inherent shortcomings of all substitutes for official (national) currencies. On the contrary: far from being inherent, the shortcomings of local currencies are ones which have been purposely built into those currencies by persons seeking to make them serve an end quite at odds with that of making it as easy as possible for people to exploit potential gains from exchange.

There is, in fact, nothing to prevent other kinds of unofficial currency from commanding a national market. The key to having them do so is that, like modern bank deposits, they must be fully compatible with the existing monetary standard, and readily useful throughout the national economy, if not beyond it.

Historically, private banknotes have possessed these qualities wherever legal restrictions haven’t prevented banks from establishing branch networks or taking other measures to make their notes current beyond the banks’ headquarters; and it is conceivable that other forms of private currency, including privately-issued token coins, could also take the place of government-supplied alternatives, **if only the government would let them**.

So, while I applaud the effort of local currency proponents to break the Federal Reserve’s currency monopoly, I regret that they’ve chosen to sabotage this merit-worthy mission by linking it to the much less worthy one of keeping people from trading with “outsiders”. As the ever-sensible Bastiat once observed, “The worst fate that can befall a good cause is not to be skillfully attacked, but to be ineptly defended.”

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