Fearing cryptocurrencies

The hope that private cryptocurrencies would become mainstream money suffered a setback last week. In his Budget speech, Finance Minister Arun Jaitley for the first time explicitly said that cryptocurrencies such as bitcoin are not legal forms of money in India and that the government would take steps to eliminate their use. Mr. Jaitley is not the only politician worldwide to consider cryptocurrencies a danger to the status quo. Under the guise of protecting investors, governments in China and South Korea recently took steps to suppress the use of cryptocurrencies, thus adding to the extreme volatility of their price moves. Why are governments so keen to destroy private cryptocurrencies?

The reason is that these currencies pose a significant threat to the massive economic power that national currencies, such as the rupee and dollar, provide their governments. Today every country's government has a legal monopoly over the issuance of the currency that its people use. This means that no entity other than the government may create and sell currencies. The very point of legal tender laws is to ban anything other than the currency issued by the government from being used as a medium of exchange.

Such government control over money, however, offers politicians enormous benefits. For example, a politician wanting to fund populist programmes can gather the funds he requires by creating money out of thin air with the help of the central bank. This will eventually lead to price inflation that affects the common man, but it at least saves the politician from having to impose higher taxes that could affect his popularity. In this scenario, the rise of cryptocurrencies offers ordinary people the rare opportunity to choose among multiple currencies in the marketplace. In fact, in a currency market free from government intervention, any private entity would be free to issue its own currency with the hope that it would soon become a hit with customers.

While this could be beneficial to citizens, who could choose between currencies, it erodes governments' monopoly control over money. In the presence of alternative currencies, for instance, people may partially give up using national currencies issued by governments, as elaborated by Austrian economist Friedrich Hayek in *Denationalisation of Money*. Instead, they might opt to use private cryptocurrencies that offer more stable or predictable purchasing power than, say, the rupee. It is thus little wonder that governments have banned or otherwise undermined bitcoin and other private currency systems.

Nevertheless, until now, cryptocurrencies such as bitcoin have failed to show signs of value stability owing to extreme price fluctuations. This is partly because they have only gained acceptance as a speculative asset rather than as a medium of exchange. In a competitive marketplace, however, such currencies are likely to be ousted eventually by competing currencies that better satisfy the tastes of buyers.

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