

Analysis & Opinion | Nicholas Wapshott

## The strange convergence of Bernanke, Hayek and Bitcoin

By Nicholas Wapshott  
November 21, 2013

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Every time Federal Reserve Chairman Ben Bernanke opens his mouth, the markets move. But few could have guessed that in an offhand remark he would add legitimacy to the Bitcoin, the virtual currency that competes with the American dollar as a reserve currency and an international trading medium.

Yet that is what he did when he held out a friendly hand to the notion of fantasy currencies in a letter to the Senate Committee on Homeland Security and Government Affairs. Understandably, this improbable endorsement from the guardian of the mighty dollar sent the value of the Bitcoin soaring.

Until recently, the Bitcoin was seen as a novel, experimental, somewhat piratical cyberspace Monopoly money that has proved useful in moving money around the world without the hampering and costly help of banks, which slow things down, waste days while the cash lingers in limbo, and take a hefty slice of every transaction. Bitcoin's headiest moment was as the currency of choice of the Deepnet black market website Silk Road, which sold everything from crack cocaine to child porn, and was closed down by the FBI last month.

Bernanke sees far beyond the illicit uses of virtual currencies as a means of paying for contraband or shuffling hot money around without being traced. He believes they could become an ingenious means whereby the globalized market in legitimate goods and services can work more efficiently without the dead hand of the banks.

The Fed chairman told the Senate Committee members, who are anxious that something outside the control of Congress will be used as a currency for criminals and terrorists, to think before consigning Bitcoin and similar monetary confections to oblivion. Forget money-laundering, he wrote, "there are also areas where [virtual currencies] may hold long-term promise."

Bernanke's guarded welcome to virtual currencies as an ingenious innovation that will liberate world trade seemed like an aside, but his glancing approval may ultimately prove a revolutionary step in both economics and politics. Competing private currencies have long been seen by free market economists as the holy grail. So long as the state governs the price of money through interest rates and insists that only one currency can be used in a geographical area, there is no chance of approaching a truly free market.

Friedrich Hayek's stunted Austrian economic notions may have failed to prevent the Keynesian revolution in macroeconomics, but his broader political vision of a world where untrammelled commerce replaces state-run, community-accountable institutions regulated by democratic bodies remains potent among conservatives. We remain a long way from his ideal of a world where countries protected by patriotism and highly-defended borders are succeeded by competing commercial city-states fueled by a borderless international free market in labor.

However, Hayek's notion that state-run currencies should compete with — and perhaps be superseded by — privately-owned currencies that would live or die depending on their ability to maintain their value came a step closer with the Fed chairman's remark. If private currencies like Bitcoin take off, economic history may trace a new era of world trading, both in goods and currencies, to the moment that Bernanke served final notice on the all-powerful state-run currencies the dollar, the euro, and the pound sterling that their monopoly days are over.

The sharp-tongued Hayek was never more acrid in his comments than when writing about the misuse by governments of their control of money and the money supply. "Practically all governments of history have used their exclusive power to issue money in order to defraud and plunder the people," he wrote in *Choice in Currency: A Way to Stop Inflation*. "There is less ground than ever for hoping that, so long as the people have no choice but to use the money their government provides, governments will become more trustworthy. ... There is no reason whatever why people should not be free to make contracts, including ordinary purchases and sales, in any kind of money they choose."

Hayek wrote this nearly 40 years ago, when the Internet was but a glimmer in Al Gore's eye. He had in mind existing currencies competing with each other, so Americans might prefer to use the yen or the peseta when they went to the store, rather than the dollar. By such competition, Hayek believed currencies would be kept honest and would not devalue as they tended to do when governments used inflation to get themselves out of fiscal trouble.

There have, of course, always been many alternatives to currencies. Bernard Lieber, a Belgian European Union official, and the journalist Jacqui Dunne found 4,000 unofficial private currencies, including frequent flyer miles, credit card points, supermarket saving stamps, and "time-bank" schemes where labor is exchanged without use of a currency, an idea adopted by New York City Mayor Mike Bloomberg to encourage community service.

### AUTHOR PROFILE



Nicholas Wapshott

Nicholas Wapshott is the International Editor of Newsweek. He previously served as New York bureau chief of The Times of London and editor of the Saturday Times of London. He is a regular broadcaster on MSNBC, PBS and FOX News. His new book "The Sphinx: Franklin Roosevelt, the Isolationists, and the Road to World War II" is due out in November. He is also the author of "Ronald Reagan and Margaret Thatcher: A Political Marriage" and "Keynes Hayek: The Clash That Defined Modern Economics."

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Virtual currencies go much further than these hokey attempts, as President Franklin Roosevelt put it when announcing Lend-Lease, "to get rid of the silly, foolish old dollar sign." Virtual currencies like Bitcoin threaten the very existence of the dollar — and much else besides. Now, when people want to avoid the inflationary aspects of central bank actions, such as quantitative easing, they invest in stocks, in the hope the market will retain or even add value to their savings. Others prefer to buy gold, even though it, too, is a gamble and can fluctuate in price.

Virtual currencies mark the death knell of such traditional safe havens and will dissolve, too, to that favorite fantasy of free market enthusiasts: the return of the dollar to the gold standard. With virtual currencies competing to maintain their value against each other as well as against the traditional currencies and precious metals such as gold and silver, the conventional ways of safely hoarding wealth may become redundant.

There is, however, a profound hitch to this brave new world. We have passed this way before. National currencies are underpinned by a country's wealth, which is why countries who run up too much debt find their currencies devalued. Governments, who currently have the sole legal right to print money, flood the market in their currency, which leads to devaluation, which in turn leads to inflation, which is what Hayek, a victim of the central European hyperinflation of the 1920s, detested above all.

The Confederate dollar was an example of a currency that collapsed as Robert E. Lee's army began losing and the Richmond Treasury ran out of hard cash. Before the Civil War there were a number of other competing currencies in America, all of which went by the board.

When they collapsed they took with them the savings of Americans who misplaced their trust in them. Without sufficient assets to maintain the currencies' value, there were quotidian runs on banks and sudden bankruptcies that made honest people destitute overnight.

If we are about to witness an explosion in competing currencies we can expect similar collapses and the human tragedies that will accompany them. Hayek looked at only the bright side, where ideal currencies kept pace with each other and goaded each other through healthy competition to maintain their value and keep inflation at bay.

But as we have seen from the events of 2007-08, even the best laid plans of bankers go awry. When things go wrong, banks desert their customers. And who picks up the pieces? Why, the elected government, of course, for it alone is responsible for the welfare of its people.

Only effective regulation can ensure that banks entrusted with our money will be there when we need to withdraw our cash. We have seen what happens when there is a lack of regulation: bankers take rash risks that threaten the whole world with penury.

The same applies to virtual currencies. Without a framework of rules, virtual currencies will leave their customers vulnerable. Caveat emptor is not a smart enough response to the prospect of currency collapses.

Hayek would agree. He did not believe in laissez-faire, which is why absolutist free market advocates like Ayn Rand called him a compromiser and spat at him at parties. He believed markets should be carefully regulated to ensure they worked efficiently and fairly.

Virtual currencies will only catch on if they are thought to be honest and reliable. And the only way of ensuring that is to treat them like conventional banks. As Ronald Reagan would put it: Trust but verify.

Nicholas Wapshott is the author of *Keynes Hayek: The Clash That Defined Modern Economics*. Read extracts [here](#).

PHOTO: One of Bitcoin enthusiast Mike Caldwell's coins in this photo illustration at his office in Sandy, Utah, September 17, 2013 REUTERS/Jim Urquhart

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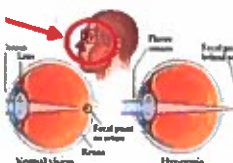
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Nov 21, 2013  
5:18 pm UTC

Five years ago, Webmoney was the least troublesome way for people outside Russia to buy online services inside Russia. Today, it's Visa and PayPal. I would say that this is prima facie evidence that where virtual currencies try to compete with other payment systems, they pretty quickly turn out to be uncompetitive.

Posted by [lan\\_Kemmish](#) | [Report as abusive](#)

Bitcoin is probably lame, but the idea of relegating anything other than existing currencies, to the world of 'fantasy currency', is clearly an exercise in ignorance. 'Fantasy currency' is actually a British term from the early 1800's, describing U.S. dollars. How did that work out for them?

Nov 21, 2013  
5:43 pm UTC

Posted by [AlkalineState](#) | [Report as abusive](#)

The article seems to miss the point that a viable alternative currency tends to make the political class more honest. The US Federal Reserve operates on the assumption that the world can recognize another reserve currency. The dollar, imperfect as it is, still inspires much more confidence than the Euro or Bitcoin. Bitcoin is probably mentioned because the Fed wants to associate private currencies with narcotics and child porn. Arguably, Bernanke's comment was a preemptive strike. If the Euro did not exist today, the Fed would be far less responsible. No one has explained how the US will handle its debt other than by inflating the currency. Other governments have followed that path since ancient times. Another alternative is a simple refusal to pay the debt: a default. But inflation is simply a time-lapse default. Other governments have done that as well.

Nov 21, 2013  
6:47 pm UTC

But for the fear of alternative currencies and negotiable items/stores of value, the United States political class might well have already used the power to create currency to devalue inconvenient obligations. Because of the internet, people today have an option the post-WWI Germans and Austrians did not have. Today, people can shift out of dollars easily and the Federal Government lacks the effective power to prevent them from doing so.

Posted by [lordbaltimore](#) | [Report as abusive](#)

Bitcoin is honest and reliable. The mathematics of it are very clear and can be verified by anyone who bothers to walk through the cryptography techniques. Further, it's much more transparent than people want to claim; 'every' transaction, from the start, is recorded in the blockchain. Every single one. Bitcoin itself does not need regulation. Existing laws still apply to bitcoin, when bitcoin is finally exchanged for a more conventional currency. In a way, Bitcoin has the potential to be a universal reserve currency, and the new 'gold standard'. No one controls it. No one has the authority to say 'okay, we'll put out more bitcoins this year.' Treating Bitcoin like it is some kind of virtual bank is entirely inappropriate. It is a virtual commodity, not a currency.

Nov 22, 2013  
3:45 am UTC

Posted by [Burns0011](#) | [Report as abusive](#)

The trust with government money is you know who issued, what it can buy, how bad it can get. Rest is a ponzi scheme.

Nov 22, 2013  
12:03 pm UTC

Posted by [daffa](#) | [Report as abusive](#)

On what planet does Bitcoin compete with the US dollar for reserve currency status? BTC price change by 20% A DAY! Can you imagine the horror of a reserve currency that was so volatile? BTC is volatile because it has extremely poor liquidity. Another reason why it is not a candidate for the reserve currency of the entire world economy. This has to go down as one of the most misinformed things I have read this year. What a joke.

Nov 22, 2013  
1:11 pm UTC

Posted by [Stu\\_ell](#) | [Report as abusive](#)

Digital currency may be on it's way, but Bitcoin? The brothers will have triumphed over the Facebook debacle permanently. The USA may have a hard time having Bitcoin taken seriously by the Chinese, Middle East, and other countries who still have a fond attachment for the shiny gold & tangible commodities. Unless we are talking engineering a total financial collapse, thereby 'seemingly' no choice, I can't see it. Barter would attain greater trust than Bitcoin, unless we are all so disconnected from real life via digital devices et al. that we cannot discern the difference. I guess we'll know in a generation or two, once they become permanently implanted into our bodies and the older folks die off.

Nov 22, 2013  
4:03 pm UTC

Posted by [MBCA](#) | [Report as abusive](#)

"...The Deepnet black market website Silk Road, which sold everything from crack cocaine to child porn..." Child pornography was never sold on Silk Road, as a quick glance at Wikipedia would've told you.

Nov 22, 2013  
5:55 pm UTC

Posted by [cheezwizard](#) | [Report as abusive](#)

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Nov 22, 2013  
9:27 pm UTC

"(S)ate-run, community-accountable" — I assume the irony was unintentional.

Posted by [Nate\\_Abele](#) | [Report as abusive](#)

Nov 25, 2013  
6:31 pm UTC

[@Nate-Abele](#),  
Only your ignorance is unintentional, I'm afraid. Community-accountable: you know, by voting?

As opposed to totalitarian governments and power systems where the community has no say, such as trans-national corporations...

Have we all forgotten the lessons of history already? Is everybody still a Friedmanbot even after the collapse of the edifice built upon his ideology?

Aug 19, 2014  
9:40 pm UTC

Posted by [Benny27](#) | [Report as abusive](#)

[...] that Bitcoin could be "legal means of exchange" and Chairman of the Federal Reserve, Ben Bernanke noted that Bitcoin "holds long term [...]"

Posted by [Bitcoin Regulation - Here it Comes - Smaulgld](#) | [Report as abusive](#)

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