FEASIBILITY OF SELECTED PRIVATE MONEY

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Received: February 20, 2012

Abstract


The goal of the entry: "Feasibility of selected private money" is the assessment of practicability of selected private money types as future currency especially in terms of attributes that the currency should meet to fulfil all claims required by its users. In the first step the features that the widely used currency has to have will be described and it will be analysed which of these features are characteristic for nowadays currencies (Czech crown and Euro) too. In the second step private (unnationalized) money will be described as well as several concepts derived from it. The paper will concern mainly on Hayek’s concept of private money and on particular variations of Local exchange trading systems. In the next part there will be pointed out good and bad features of these types of money, mainly from the view of characteristics that the proper currency should have. At the end it will be carried out the comparison of bad and good effects resulting from using of particular currencies types and I will decide about the applicability of analysed private money types.

The paper uses the standard methods of scientific work. Firstly, the method of description is used to describe the development of private money concepts and characteristic features that the currency should have. Then, a comparative analysis is used to discuss the differences between contemporary currencies and unnationalized currencies as well as between required and real features of particular private money. At the end the method of synthesis, deduction and induction is used.

private money, LETS, LET System, feasibility, local currencies, functions of money
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determine what types of currencies will be made up and there will be
good effects resulting from using of particular types
should have. Then, a comparative analysis is used
to discuss the differences between contemporary
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as between required and real features of particular
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The information were collected from the
literature, from scientific papers and from the
Internet too.

RESULTS AND DISCUSSIONS
Local currencies systems and private money in
general originate as a reaction on the concrete
problems. They are designed for solving of specific
situations and very often they are dependent on
one person or on a small group of people. The
result is that every system is amended by particular
leaders to their specific form. From the most known
systems are often mentioned private money in their
pure form created and characterized by F. A. Hayek
and Local Exchange Trading Systems1. Before the
analysis will begin, we should start with the features
that the currency should have.

Functions of money
Samuelson and Nordhaus (1992, p. 238) told
that “Money is anything that serves as a commonly
accepted medium of exchange or means of payment” as it was mentioned in the introduction.
By others authors there is instead of “anything”
– used word “asset”. But it is terminologically not
correct because money can be liability too – e.g.
for central bank. But for aims of this paper we will
consider it as an asset that should have the following
features.

The first function is medium of exchange2. It is the
oldest function of money. Before the origination of
money there was only the direct exchange. That means
that the owners’ rights to both changed assets (in an
easy example directly these assets) are transferred
directly to final consumer. The basic condition of
such exchange is, however, double coincidence of
wants. That means that the first owner wants the
asset that possesses the second owner, vice versa.

This problem led to creation of indirect exchange.
During such transaction (Rothbard, 2001, p. 29 and
30) is the first owner’s asset exchanged in one or
more steps for other kind of asset leading to the final
object of its wants. It causes that for the participants
is not important the utility value but they are
interested in exchange value3. These transactions
are specific for barter economy. Because of high
transactional costs there has been segregated
specific merchandise with characteristics like
liquidity, homogeneity, divisibility, manipulability,
durability, storability, scarcity and invariance, that has started to be used as a medium of exchange even though it doesn't have to have any other own utilisation. It didn't let to cease of barter but it frequency decreased.

When we want to assess the Czech crown as a medium of exchange we will find out that it fulfil this function very well, mainly at the area of the Czech Republic (further abbreviated as CZ too). It can be – with some limitations – used also in almost the whole Europe but except the border areas around the Czech Republic it has firstly to be changed in other national currency (e.g. in Euro). The Euro fulfils this function better – it is commonly used medium of exchange in the whole European Currency Union (further as “ECU”) and it is widely accepted in a lot of countries around the world. The only world’s competitor to Euro in this function can be only US dollar.

The second function is store of value. Except medium of exchange money can be used as some specific form of capital investment (Konečný, 2008, p. 174 and 175). In case that people voluntary postponed present consumption in favour of the future consumption they usually claim that the future utility of this consumption should be minimally the same or higher than the present one. That means that the value should not decrease. But how can it be explained that most people have part of their assets converted in money even though the price level increases and cash in hand doesn't produce any revenues and cash in bank only small revenue interests? It is caused by the fact that the majority of people prefer other function of money than the store of value – liquidity. Cash in hand (or less cash in bank) can be thus immediately used for purchase of products, merchandise or services or for payment of our liabilities. In addition, as a store of value are used also the other kinds of assets – and maybe with better results.

For assessment of Czech crown (further as CZK) and Euro as a store of value will be used inflation rates. For the comparison there was as inflation rate selected average annual rate of change of The Harmonised Index of Consumer Prices gained from Eurostat's database because this rate is used both by Czech statistical office and The European Central Bank.

As it is depicted above in the diagram 1 the inflation in both studied areas between years 1997 and 2010 markedly fluctuated (mainly in case of the Czech Republic). The average inflation rate was in selected period 2.0 % in Euro area (16 countries) and 3.5 % in the Czech Republic. That indicates that both currencies lost its value and didn't replenished the function of storage of value very well but in the comparison it can be better evaluated unitary European currency.

The third general purpose of money mentioned also by Jones (2011, p. 57) is unit of account. This function

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4 as a part of function called medium of exchange
6 It is worthy to say that in this comparison was not considered year 2011 (because of unavailable certifiable data for ECU and the Czech Republic) and the years before 1997 (because the European Currency Union doesn’t subsist for such a long time). But in case of data from the Czech Republic there can be seen even higher rates of inflation in the previous years. That infers that even not in these years was the Czech currency effective storage of value.
purpose logically resulted from the fact that the specific asset that is widely accepted as a mean of payment is going to be value basis used for price expression of all traded assets. It makes the exchange process clearly because particular traders don't have to know values of traded merchandise in units of other goods. In addition this way enables its users to express value of loans, i.e. time value of money.

From the view of the Czech currency it fulfills this purpose at least in the whole Czech Republic. It is stated by the legislation – the Accounting Act\(^7\) in § 4, Nr. 12 claims: “The accounting units are obliged to keep its accounting in money units of Czech crown. In case of receivables and payables, business companies shares, securities and derivatives, and valuable assets that are expressed in foreign currency, and foreign currencies, are accounting units obliged to use concurrently foreign currency too; this obligation is applicable for adjusting entries, allowances and technical reserves if they have been concerning assets and liabilities expressed in foreign currency.”

The same obligation is stated in legislation of particular members of European Currency Union\(^8\).

Except these three general features there are (by some authors) added 2 additional functions too. Lietaer (2001, p. 373) presents as additional functions of money Instrument of speculation and Tool of empires. The fourth function is therefore Instrument of speculation – according to his opinion it is unassailable because 98% of all foreign exchange trading has become speculative. But origination of this function was possible only thanks to cease of Breton-wood system and accordingly to discipline of countries that wants to get loan from them.

In this part there were discussed functions of money and feasibility of Euro and the Czech currency in the view of these function. But in addition we should furnish that there can be some assets that fulfil some of these functions but despite that they are not money (e.g. cattle was sometimes used to express the value of assets or liabilities but was not used as mean of payment).

F. A. Hayek's concept of private money

In this part will be analysed and assessed the concept of private money developed by F. A. Hayek. It is not the first concept of such money but it was the first sophisticated and a little widely known concept. Hayek itself in his beginnings argued that money should be issued by state – despite his opinions on private property. But then he changed his mind and suggested (Hayek, 1999, p. 11–14) concurrently used currencies market opened for both government and private issuers. These currencies would not be convertible into commodities but every issuer would guarantee stable purchasing power according to stated commodities. Mutual competition should ensure that the currency value would remain the same. Such a currency would be issued by purchase or selling of other currencies or commodities or by short-term bank loans. It would enable the issuer to change the volume of issued money according to the currency demand. It would be probably necessary (Konečný, 2008, p. 174 and 175) to make some precautions against parasitic currencies\(^10\) – i.e. credit money issued by other banks – that should ensure us to be able to influence the volume of issued money.\(^11\)

This concept, however, has its faults. The commodity guarantee is not legally binding for the issuer. Will the debtors have to pay back their loans in this kind of money even though the currency has appreciated? Money is network asset that means that the user's utility increase according to the total number of involved users, therefore there should be some incentive for entering the system. That could be certain percentage of new currency given as a gift or (Murphy, 2005) the users could apprehend the currency purchase as a capital investment (because they are sure about the currency stability) and even though they could pay some additional money to the issuer (some kind of share premium).

\(^7\) Author's own translation of Act No. 563/1991 Coll., Accounting Act, as amended by later acts.

\(^8\) E.g. in the Slovak Republic it is stated in act No. 431/2002 Legislation Collection, Accounting Act, as amended, in § 4, No. 7.

\(^9\) Abbreviation „Comecon“.

\(^10\) Please take note that these “parasitic currencies” are quite similar to currencies of current commercial banks – these banks parasite on central bank currency too.

\(^11\) It can be done by the way that the primary issuer would publish that he will not issue any additional currency to settle liabilities of secondary issuer. That would probably lead to system resembling “banking of utter coverage”.
According to Hayek's ideas probably operated the experiment of the economist Ralph Borsodi and Robert Swann who in 1972\textsuperscript{12}, in Exeter (New Hampshire, USA) started issuing a currency that was based on a standard of value using 30 different commodities in an index similar to the Dow Jones Average. It was called the Constant because (not as the national currency) it would hold its value over time. The aim of Constant was to prove that people would use currency which was not the familiar US dollar. Borsodi discontinued his experiment after a year, but it has fulfilled its aim: to demonstrate local acceptance and verify the legality of locally issued, non-governmental currencies. If you are interested in legality of such project, Borsodi tried to find it out for the United States of America and he checked it with the Treasury Department. His friend, who asked them, was told (Swann, Witt, 1995, p. 4 and 5), “We don't care if he issues pine cones, as long as it is exchangeable for dollars so that transactions can be recorded for tax purposes.” I guess that this is all that the governments in the most countries require of a local currency. And all that a local currency requires of a community is the trust.

### Local Exchange Trading Systems

As a subsystem of private money, similar to Hayek's concept, are sometimes mentioned LET systems. But it is similar only on the first sight because they originated differently and from different reasons. The aim is mainly the simplification of merchandise/services exchange between socially excluded people or between the members of community. It usually originates in this way (Konečný, 2007, p. 36 and 37): every community member who has signed enter contract and paid membership fee\textsuperscript{13} will get cheque book in the local currency. Then the new participants create list of products or services that they want to sell – including the price in local currency and these lists are periodically actualized and sent to the community members. In case of product purchase you have to send cheque to the “banker” – this system is thus based on multilateral clearing principle.

However, widely extended are LETS based on mutual credit principle. In this LETS every member starts with zero state of local money account and the currency is in the system beginning issued via mutual credits. This implicates that the currency is issued according to member's needs (in stated limits) and the fact that someone has to have “loan” to be able to “send” someone else the money (total balance of all system participants is zero). From these “loans” there are not paid any interests and in the price should be no profit margin. This independent attitude to money can be expressed more accurately in Michael Linton's words: „Money is actually an immaterial measure, like a centimeter, a liter, a kilogram or a degree. Whereas there is a definite limit to real resources (only so many tons of wheat, only so many meters of cloth, only so many hours in a day), it is not possible to be lacking in means of measurement” (Doole, 2000, p. 4).

Probably you are asking how it is treated with the members who want only to purchase (on credit) and not to produce. It seems that such situations don't originate because of social control – account statements are often open and sent to all participants or in case of electronic systems the data are publicly accessible via internet. Other systems are based on member's notes that are periodically mutually checked.

LETS are usually democratically based but strongly influenced by their founder or organizational centre. This personal unstableness is their weakness even in cases when they are founded by some ecologic organizations (btw. ecologic views are often important incentives for establishing of such organizations). In the LETS local currencies are mostly traded services (teaching, consultancy, accommodation, etc.) or older or hand made products.

The LETS currencies can be emitted in two basic ways (according to the system type) – as banknotes, cheques or coupons, or – more often – in electronic form. This system is a little bit cheaper but from the point of view of common people less trustworthy because they are used to physical form of money. But it will (according to credit card payments development) maybe change in the future. The advantage of electronic form is also evasion to legal problems with printing of own currency that can be illegal in some countries.

The currency value can be at the system beginning stated as an approximate equivalent of government fiat money\textsuperscript{14} or as a time unit. The second possibility is, however, not often because it draws a comparison between one work hour of skilled and non-skilled person. The disadvantage of first way is in turn dependence of local money on government money and thus possibility of crisis distribution.

### CONCLUSIONS

In this paper there was analysed the feasibility of private money focusing mainly on Hayek's private

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12 It is quite the same time when F. A. Hayek published his concept but nor Hayek (Hayek, 1999) and probably either Borsodi had known about the other's ideas.
13 Membership fee is paid periodically and sometimes there are paid transaction fees too (partly in local/official currency). These payments are used for operating of the systems and the higher fees (from business companies) for the development of the community. For the companies it is relatively cheap way of marketing in steady sphere.
14 It is easier for value determination and there are no problems with conversion into government money because of tax and accounting purposes.
money and LET systems from the view of their basic functions. In the first part there was accomplished short overview of these functions and there was analysed how efficient are some of the currencies currently used in the Czech Republic and its neighbourhood too. Except studied positive and negative features of these government fiat money there should not be forgotten (Riegel, 1944, p. 8 and author) three additional characteristics:

It permits (and force) the government to issue unbacked money. No government produces so many products to enable her to back by them its money – if it produced, it would be direct attack on private enterprise. And money without backing can cause an indirect attack on private business through inflation.

It permits money to be issued privately, but only by a limited number of persons and corporations – in the form of loans. Thus it establishes credit as a privilege rather than a right, and makes it an object of profit rather than a utility to further the production and distribution of wealth. Generally it denies to producers the right to issue money, thus restricting their future development.

Wide spread currencies (like Euro) enable international business and transfers but on the other side they frequently cause the transfer of wealth from the poor districts to the rich ones.

Now will be analysed the other possibilities mentioned above, i.e. Hayek’s concept of private money and LET systems. The major benefit of Hayek’s private money should be probably its stability because its value would be defined upon the commodity index (i.e. due to its approximately constant production in the time and certain mining limits). The commodity basket is also able to reflect the preferences of money holders according to their interests. Another interesting feature of the system is that money holders would themselves reap the advantages of the currency inflation – instead of the issuing firm. Why? In case that the currency (based on agriculture products) would be generally accepted, the market will in the course of time increase the production and thus the prices will decrease. For preservation of stable purchasing power it will be necessary to issue new currency units. If the company were monopoly or oligopoly (as the government and commercial banks are) they would spend newly issued currency units themselves but in case of wider competition they should distribute these units to its holders – e.g. in the form of deposit interests.

However, the concept has its drawbacks. The first (non-mentioned yet) one is the argument that a private “central bank” would never intentionally make inflation. The company will maybe always find the hyperinflation more profitable. It is true that it will cause that the public will reject the currency, but so what? If there is stated (in the short run relatively constant) exchange rate why not print up fifty billion currency units and buy as many real merchandise as possible? This one-shot step will probably earn more than the present discounted value of long-term revenues. As a solution we can suggest some warrants as partial currency convertibility into the commodity basket or the company legal pledge that they will never increase the supply of the currency by more than certain percentage per year.

The second one is functional background like fast and reliable judiciary, commercial law, flexible labour market, accounting standards, auditing standards, intelligent and well informed users etc. Moreover, right system operation expects competition between government fiat money and more private currencies. That should probably have to lead to using of electronic payments system (mainly in case of small value coins) instead of coins and banknotes.

Hayek itself (Hayek, 1999, p. 33 and 34) recognizes in the comparison to current governmental fiat money only one problem in his concept – in the present system are unified prices and currency units. But from his point of view it is not more important than repeating inflation and economic crises.

From the analysis and from the historical Borsodi’s experiment we can deduce that this system probably best meets the characteristic “store of value” and thus it would be a perfect unit of account. Concerning “medium of exchange” I – in the contrast to Konečný (2008, p. 175) – state that it would meet it only on average because of more currencies existence and thus of the possibility of currency unacceptance in all shops/transactions. It could be instrument of speculation but if the rules were stated correctly, probably it wouldn’t be and undoubtedly it would not be tool of empires.

The aim of Local exchange trading systems is facilitation of exchange. It is tool of cheap marketing and enables exchange even in causes when it won’t be commonly favourable – in prices are not actually profit margins. Important advantage is possibility of getting credit exactly in the moment when you need it and what’s more – with zero (cost) interest. Local currencies don’t directly influence employment rate but they indirectly can (when used as an additional currency to the official) enable socially excluded persons to work and gain some work knowledge before the official job getting. They are also resistant to receiving of external economic crisis because they are separated.

The other advantages of LETS are their social and ecologic impacts. LETS involve community members in community life and connect them. According to Schraven’s (2000) and Williams’s (1995) study: “the dominant portion of LET System members consists of ecologically oriented people. 

15 Translated by author from Foltýnová, 2004, p. 60.
looking for an alternative to current economy and people gasping for more socially equal society. Ecological aspect we can find in the localness of production that causes lower transport costs and local currencies also encourage the recycling of resources.

As a disadvantage are usually mentioned administrative and economic costs during its foundation and in the first years of its run. It strongly depends on the personality of its founder and his/her (unpaid) effort. Financing of some LETS sometimes depends on unstable sponsor's gifts.

As declared above it is often discussed the extent of LET Systems. The first opinions told that it should be only small groups where the people know each other and thus they can prevent the “free rider” effect. For example local currencies like LETS in the United Kingdom circulate within a defined space at a very local scale and are not transferable. But if we look into the world we can find another example too, like Argentina's “Red Global de Trueque” and “Global Barter Network”. Argentina's barter network was founded in 1997 (North, 2005, p. 227) in Buenos Aires by an environmental nongovernmental Regional Self-sufficiency Programme which wanted to address poverty and unemployment in an ecological way. In its beginning the project involved only 20 neighbours who traded with 'credit notes' but throughout the late 1990s it grew and the organizers claimed that there were held – across Argentina – about 4 500 markets that were used by half a million people spending 600 million credits (North, 2005, p. 228). During the Argentina's crisis starting in December 2001 alternative currencies became fundamental for survival and barter networks had spread all over Argentina16. We should notice that there were a lot of local currencies that were only based on the same principles and had the same system. Some currencies were also accepted in other “nodes” and some not, but I think that this situation demonstrated that such systems are feasible in bigger volume too.

The main function fully satisfied by LETS currencies is medium of exchange. As unit of account it is used more likely seldom but it is caused only by governments' attitude due to tax and accounting reasons. On account of that there are the LETS currencies connected to official currencies but this relation can produce transfer of government money problems. The second problem with currency as unit of account is the fact that accounting is kept to provide external users with clear information and that is possible only when all accounting units measure in the same measurement unit (or the conversion is possible). Thus it will not meet this function duly till the time of wide (one or a few) LETS currency/ies acceptance. Another question is if the LETS currencies can serve as store of value. Probably it should be possible in short run17 but as a source of instability there can be found the lifetime of currency in the long run. LETS currencies are not used as an instrument of speculation and as a tool of empires only from the view that in small LET systems is the production ability of participants little “controlled” by other members. Certain results concerning impletion of the functions by analysed currencies are briefly depicted in the Chart I.

Last point influencing fulfilment of the currency functions that will be discussed is confidence. For every type of currency it is true that it is only as strong as the confidence that people have in it. In case of Euro and the Czech currency is this confidence strongly affected by macroeconomic indicators and prospects. Nowadays increase influence of expert opinions presented in media and of assessments of

<table>
<thead>
<tr>
<th>Currency Functions</th>
<th>Current fiat money</th>
<th>Hayek's private money</th>
<th>LETS currencies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Medium of exchange</td>
<td>Fully in ECU, partly in adjacent countries</td>
<td>Fully in CZ, little in adjacent countries</td>
<td>Average, depends on currencies quantity</td>
</tr>
<tr>
<td>Store of value</td>
<td>Average</td>
<td>Worse than Euro</td>
<td>Very good</td>
</tr>
<tr>
<td>Unit of account</td>
<td>Fully in ECU</td>
<td>Fully in CZ</td>
<td>Very good</td>
</tr>
<tr>
<td><strong>Additional</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instrument of speculation</td>
<td>Yes, less than Euro</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>A tool of empires</td>
<td>Yes, yes, but far fewer than Euro</td>
<td>No</td>
<td>Scarcely</td>
</tr>
</tbody>
</table>

Source: Own construction

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16 The largest “node” (‘market’ in Spanish), in suburban Mendoza, claimed 36 000 participants.

17 These types of currencies probably are not very inflationary ones because they are covered by products and services or by believe (and control) of other participants that issuer is able to create values. On the other side some (infrequent) LETS systems are designed in such way that they regularly lose certain percentage of its value. This characteristic should accelerate the consumption and thus stimulate local economy.
three world-biggest rating agencies too. In case of Hayek's private money is probably the confidence sufficient because the currency is "covered" by commodity index. The only reason for uncertainty could be doubts about the issuer's honesty, i.e. about the possibility of fraud. Brightly can be the substance of confidence in money seen in case of local exchange trading systems currencies. Here is as the basis regarded confidence in someone another to produce something of value. The currency is thus only as strong as its issuer's production power.

From the comparison with current government fiat money and from assessment of function accomplishment we can see that analysed types of private money are feasible and the only problems that can influence their using are (except possibly government prohibition) their acceptance and therefore their expansion between their users. From the two analysed money types is probably better Hayek's concept of private money because is better organized and it can be used at larger area.

**SUMMARY**

The objective of the paper: “Feasibility of selected private money” is the assessment of practicability of selected private money types as a future currency especially in terms of attributes that the currency should meet to fulfil all claims required by its users. The features (gained by literature research) can be divided into two main groups: general and additional. Widely mentioned are these three – Medium of exchange, Store of value and Unit of account – but some authors also use as additional characteristics Instrument of speculation and A tool of empires. In the first chapter concerning these features there was carried out analysis how much current government fiat money (there were analysed Euro and the Czech currency) comply with these attributes. It has been ascertained that the functions Medium of exchange and Unit of account are best met by the euro currency, at least in the European Currency Union. As a better Store of value can be assessed Euro too but in this category were the results good nor for Euro either for the Czech crown. In studied period (between years 1997 and 2010) lost Euro (in Euro area – 16 countries) on average 2.0 % per year and the Czech crown 3.5% per year (according to The Harmonised Index of Consumer Prices). Both currencies can be used as Instrument of speculation and Euro as A tool of empires too.

In the next step there was described the essence of private (unnationalized) money concerning mainly Hayek’s concept of private money (with the practical Borsodi’s presentation) and Local exchange trading systems. In the text I have also pointed out good and bad features of this currency types. At the end there has resulted from the comparison that Hayek's concept is more complex from the economic point of view and probably would better meet stated characteristics, mainly Store of value. On the other side LETS currencies have other important positives that cannot be strictly economically assessed like important ecologic and social aspects. In any case impletion of the features depends on extension of particular currency acceptance between its users.

Acknowledgment

The paper has arisen of the research project of FBE MUAF Brno, MSM 6215648904 „Czech economy in the process of integration and globalization and the development of agrarian sector and sector of services in new conditions of European integrated market“.

KONEČNÝ, A., 2007: Systémy místních měn jako alternativní lokální měnový systém (Local currencies systems as an alternative local currency system). Periodica Academica, Brno: VŠKE Brno, 1, p. 35–46. ISSN 1802-2626.


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