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Bitcoin and Libra: The (Central Bank) Empire Strikes Back



Bitcoin and other cryptocurrencies paved the way for decentralized money, recently followed by Libra. However, central banks could now enter the stage and provide the most competitive currency option. Are we heading towards “the end of money” as we’ve known it? Not really: central banks, whose old cash money is being marginalized, are actually aiming to strike back, and implement digital cash which will supersede private cryptocurrency attempts. As Tancredi Falconeri said, “Everything must change in order for things to remain the same”: central banks are simply going to try and win the cryptocurrency battle for market share and legitimacy, using regulation, centralization and security as their killer advantages.

Money has been progressively dematerialized

First, let us acknowledge that ever since the dawn of the 20th century, we’ve been witnessing the progressive dematerialization of what we call money. In his book “The Philosophy of Money” (1900), German philosopher Georg Simmel defines money as “the autonomous expression of the relationship of exchangeability between objects”. The thing is, other mechanisms have taken over this function since. Professor Dembinsky analysed whether money still ticked all the boxes of Simmel’s definition and found out that no, it no longer does.

In 1971, money ceased being convertible into gold. Then came the anti-inflationary policy era, which lasted until 2007. After that, the monetary system entered a life-support, constant easing regime. Looking back over the past 30 to 40 years, we realize that the reserve function and the buying power of money have shifted from cash towards an ever-growing spectrum of financial assets, with varied degrees of liquidity. These have taken over cash’s previous function of purchasing power preservation.

As to money as a means of payment, the shift from cash to electronic systems, credit cards and private payment networks has privatized the payment function. Miles, bonus cards, vouchers and local currencies have emerged as private competitors to legal money, hybrid competitors, which Dembinsky calls “quasi-money” or quasi-monetary units. Thus, a crack appeared between the noble currencies and the commoners, or quasi-currencies. The payment function has established its autonomy from the currency itself. And there is no looking back. Fiat money is losing its previous functions to specialized subsystems. With money threatened in its essence, the very existence of central banks is called into question.

Libra has several risks

Central banks have been the providers of the legal means of payments for nations. Now, we are seeing the rise of cryptocurrencies, and lately of Facebook's Libra currency. Professor Sergio Rossi considers Libra a positive evolution from Bitcoin, since it qualifies as a stablecoin, backed by a solid fiat currency basket, to which bonds were added. Being based on monetary and fixed income assets makes it less volatile than Bitcoin, which is backed by nothing. The stated objective is to offer to people without bank accounts the possibility of accessing a payment network. But the aim is also to make a profit, obviously.

The buzz created around Libra isn't fooling Professor Rossi, though. He sees liquidity risks, regulatory risks, exchange rate risks, tax evasion risks and systemic risks. “Libra simply has no legal tender status in Switzerland”, says former law professor Pierre-Louis Manfrini. Actually, one should be aware that governments will always be a threat to a “currency” that is not theirs, until full regulation is over and done with. Or until they implement their own legal tender in electronic form. And that is exactly what they consider doing.

Clearly, the universal ambition of Libra has accelerated the thinking at central banks. They don't intend to simply watch from the sidelines. They are already studying which technology they could use in order to launch central bank digital currencies (CBDC). The idea is for central banks to provide digital cash, or legal tender in electronic form, to citizens, through digital wallets deposited at commercial banks on behalf of the central bank.

Bitcoin as the last stage of money dematerialization

Just like scriptural money took over from cash, and then cashless, contactless and mobile payments took over, blockchain closed the deal: it is the last stage of money dematerialization. Except that the final battle could happen between private cryptocurrencies and their future public alternatives, which could end up winning the battle. Experts such as Rossi are adamant: there will always be central banks on top of the system, simply because they are needed to maintain law and order.

Conversely, in a decentralized private cryptocurrency system, there is no single entity to be held accountable for the integrity of the whole and to enforce the rules of functioning. Sovereign cryptocurrencies will probably prevail for this reason; and in the end, only the form will be dematerialized, not the essence. If the essence had changed, the world would have shifted to decentralization. But if central banks prevail, central control will remain, only adding an electronic feature.

So Libra might not, after all, end up replacing central banks in the developed world. What of the emerging countries? Well if these countries don't manage to sustain effective institutions, capable of finding the right technological solutions for digitalized cash, a mechanism like Libra could very well fill the void, warns Professor Cédric Tille from the Graduate Institute of International and Development Studies. This means the possible disappearance of central banks in some poor countries, and a loss of monetary autonomy.

This is no desirable outcome and the term “digital colonization” coined by Tristan Nitot, CEO of Qwant, comes immediately to mind. More than anything though, Libra will push the most able central banks to create their own digital currency. Advanced countries are the best prepared to take up the challenge, according to Cedric Tille, and this may widen the gap between G7 central banks and the rest of the world, stuck with traditional currencies or falling for the Libra solution or for Libra-like Asian private mechanisms developed by the extremely advanced Alibaba and Tencent groups.

The pressure for central banks to adapt

Central banks are under tremendous pressure to adapt, innovate, and enter the 21st century by creating central banking digital currencies that would combine all three features of cash, bank deposit money and central bank reserve money. More than 90 central banks are seriously considering the change, although a crypto-Swiss franc is not yet in the cards. There is some hope raised by the “Wermuth initiative”, named after a Swiss politician who required in March 2018 a feasibility study for the creation of a “cryptofranc”, and got the support of the Federal Council.

Central bank digital currency will not be based on a decentralized ledger technology, according to a report written by Virgile Perret, an expert at “L'Observatoire de la Finance” in Geneva. He foresees that private cryptocurrencies will face serious competition if central banks offer a public alternative, combining the “best of both worlds”, i.e. the issuance of a digital currency with legal tender and all the advantages of digitization, while avoiding the risks of private non-legal digital currencies. Logically, the sovereign version will win the trust battle, as long as states are those who have the last word on what is, and what is not, “legal tender”.

In summary, bitcoin and other “rogue” cryptocurrencies pioneered the technology and still are the only ones to offer a decentralized solution. They were followed by a more reassuring and less volatile proposition, Libra (Facebook). And now, central banks could enter the game, reaping the benefits of the technological innovations while offering the safest and thus most competitive option – at the cost of giving up the attractive prospect of a decentralized system.



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