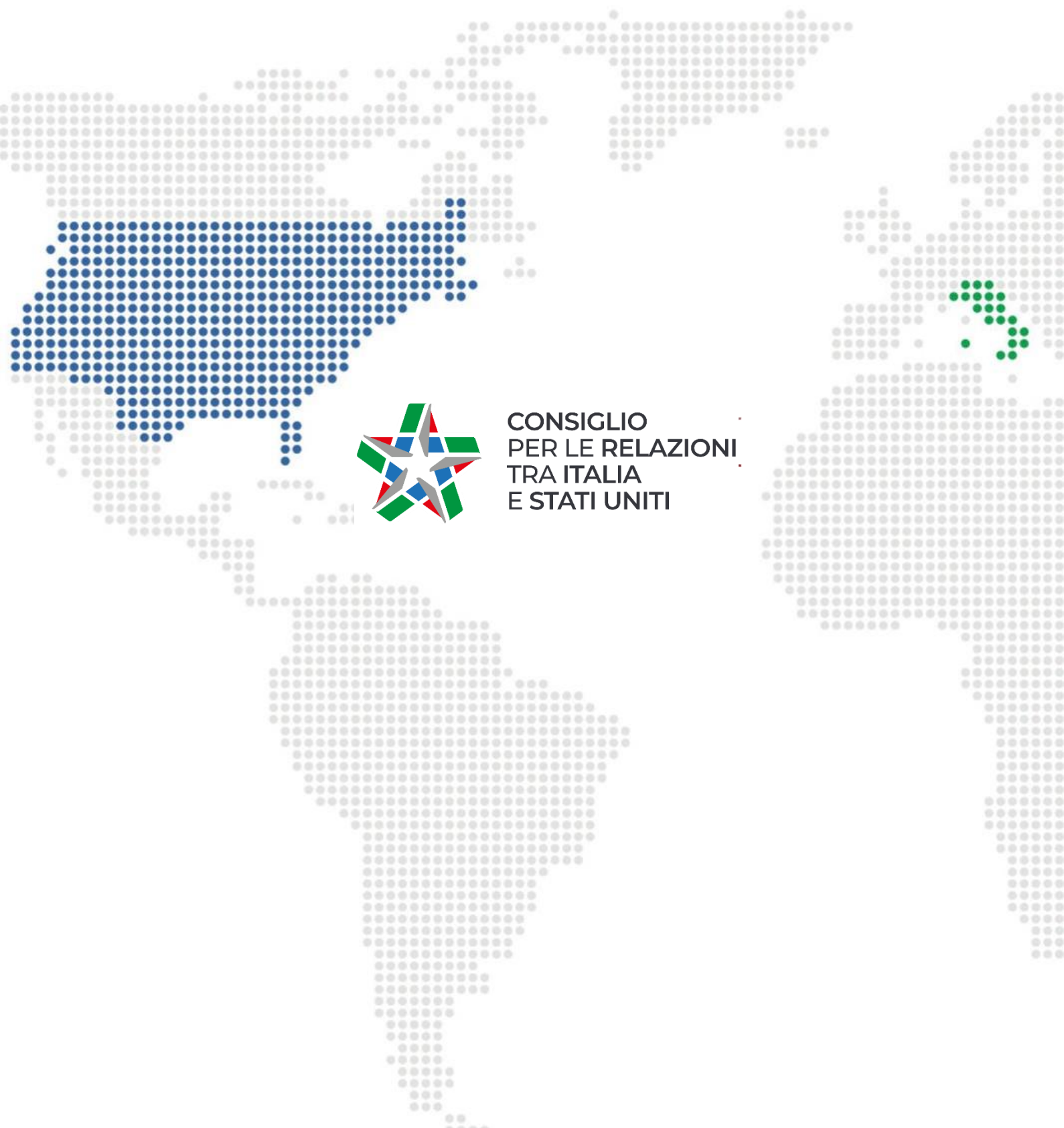


March 2021 - II



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## “COVID COIN?”

(Project Syndicate – August 5, 2020)



**Kenneth Rogoff**, Professor of Economics and Public Policy at Harvard University and recipient of the 2011 Deutsche Bank Prize in Financial Economics, was the chief economist of the International Monetary Fund from 2001 to 2003. He is co-author of *This Time is Different: Eight Centuries of Financial Folly* and author of *The Curse of Cash*.

*The COVID-19 pandemic is accelerating the long-term shift away from cash, and monetary authorities risk falling behind. A recent report from the G30 argues that if central banks want to shape the outcome, they need to start thinking fast.*

CAMBRIDGE – As the COVID-19 crisis accelerates the long-term shift away from cash (at least in tax-compliant, legal transactions), official discussions about digital currencies are heating up. Between the impending launch of Facebook’s Libra and China’s proposed central-bank digital currency, events today could reshape global finance for a generation. A recent report from the G30 argues that if central banks want to shape the outcome, they need to start moving fast.

Much is at stake, including global financial stability and control of information. Financial innovation, if not carefully managed, is often at the root of a crisis, and the dollar gives the United States significant monitoring and sanctions capabilities. Dollar dominance is not just about what currency is used, but also about the systems that clear transactions, and, from China to Europe, there is a growing desire to challenge this. This is where a lot of the innovation is taking place.

Central banks can take three distinct approaches. One is to make significant improvements to the existing system: reduce fees for credit and debit cards, ensure universal financial inclusion, and upgrade systems so that digital payments can clear in an instant, not a day.

The US lags badly in all these areas, mainly because the banking and financial lobby is so powerful. To be fair, policymakers also need to worry about keeping the payments system secure: the next virus to hit the global economy could well be digital. Rapid reform could create unexpected risks.

At the same time, any effort to maintain the status quo should provide room for new entrants, whether “stable coins” pegged to a major currency, like Facebook’s Libra, or redeemable platform tokens that large retail tech companies such as Amazon and Alibaba might issue, backed by the ability to spend on goods the platform sells.

The most radical approach would be a dominant retail central-bank currency which allows consumers to hold accounts directly at the central bank. This could have some great advantages, such as guaranteeing financial inclusion and snuffing out bank runs.

But radical change also carries many risks. One is that the central bank is poorly positioned to provide quality service on small retail accounts. Perhaps this could be addressed over time, by using artificial intelligence or by expanding financial services offered by post office branches.

In fact, when it comes to retail central-bank digital currencies, economists worry about an even bigger problem: Who will make loans to consumers and small businesses if banks lose most of their retail depositors, who comprise their best and cheapest source of borrowing?

In principle, the central bank could re-lend to the banking sector the funds it gets from digital currency deposits. This would, however, give the government an inordinate amount of power over the flow of credit, and ultimately the development of the economy. Some may see this as a benefit, but most central bankers probably have deep reservations about assuming this role.

Security is another issue. The current system, in which private banks play a central role in payments and lending, has been in place around the world for more than a century. Sure, there have been problems; but for all the challenges banking crises have created, systemic breakdowns in security have not been the major issue.

Technology experts warn that for all the promise of new cryptographic systems (on which many new ideas are based), a new system can take 5-10 years to “harden.” What country would want to be a financial guinea pig?

China's new digital currency offers a third, intermediate vision. As the G30 report describes in greater detail than previously available, China's approach involves eventually replacing most paper currency, but not replacing banks. In other words, consumers would still hold accounts at banks, which in turn would hold accounts with the central bank.

When consumers want cash, however, instead of getting paper currency (which is rapidly becoming passé in Chinese cities anyway), they would receive tokens in their digital wallet at the central bank. Like cash, the central-bank digital currency would pay zero interest, giving interest-bearing bank accounts a competitive edge.

Of course, the government can change its mind later and start offering interest; banks may also lose their edge if the general level of interest rates collapses. This framework does take away the anonymity of paper currency, but many monetary authorities, including the European Central Bank, have discussed ideas for introducing anonymous low-value payments.

Last, but not least, a shift to digital currencies would make it easier to implement deeply negative interest rates, which, as I have argued for many years, would go a long way toward restoring the potency of monetary policy in crises. One way or another, the post-pandemic world will move very fast in payments technologies. Central banks cannot afford to play catch-up.

## “WHO NEEDS A DIGITAL DOLLAR?” (Project Syndicate – March 9, 2021)



**Barry Eichengreen** is Professor of Economics at the University of California, Berkeley, and a former senior policy adviser at the International Monetary Fund. His latest book is *The Populist Temptation: Economic Grievance and Political Reaction in the Modern Era*.

*Recently, the idea of a digital greenback elicited support from US Treasury Secretary Janet Yellen and Federal Reserve Chair Jay Powell. Ultimately, the advantages of a digital dollar will need to be weighed against the potentially high costs and significant risks to the financial system that come with it.*

BERKELEY – The idea of a digital dollar has been in the air for some time now. Recently, it descended from the ether to the lips of US Treasury Secretary Janet Yellen and Federal Reserve Chair Jay Powell. At an event in February, Yellen flagged the idea as “absolutely worth looking at,” adding that the Federal Reserve Bank of Boston, in conjunction with academics at MIT, was already doing so. In Congressional testimony the following day, Powell called a digital dollar “a high priority project for us.”

Some see this as another front in the technological cold war between the United States and China. The People's Bank of China (PBOC) will almost certainly be the first major central bank to roll out a digital currency, in 2022 at the latest. If the US doesn't move quickly, it will fall behind. America's financial system will remain stuck in the twentieth century, damaging US competitiveness. The dollar's position as the dominant international currency will be eroded by the ease of using China's digital unit in cross-border transactions, and the US will squander a singular source of monetary and financial leverage.

In fact, such concerns are either overblown or flat-out wrong. The PBOC's main motivation for issuing a digital renminbi is to create a government-controlled alternative to two very large and loosely regulated digital payment platforms, Alipay and WeChat Pay.

The ubiquity of Alipay and WeChat Pay raises the specter of the Chinese authorities losing control of payment flows through the economy. And because they use information on payments to inform their lending activities, their pervasiveness points to the possibility of the authorities losing control of financial flows and credit allocation more generally. Thus, the PBOC's determination to issue a digital currency is part and parcel of the Chinese government's decision last November to quash the initial public offering of Ant Group, Alipay's corporate parent.

The American government has no analogous worries. In the US, scores of different platforms, such as PayPal, Stripe, and Square carry out digital payments, which are ultimately settled by banks, and hence through Fedwire, the Federal Reserve's in-house system for clearing interbank transactions. Visa, Mastercard, Discover, and American Express process the lion's share of card-based payments, but their actual cards are issued by banks, which are regulated, limiting risks to the payments and financial system. Here, too, settlement occurs through Fedwire.

Similarly, it is important to bear in mind how far the renminbi lags behind the greenback as an international currency. Currently, China's currency accounts for a mere 2% of global cross-border payments, a negligible share compared to the dollar's 38%.

To be sure, the convenience of a digital renminbi would hasten its uptake in cross-border transactions. But that digital currency might also have a hidden backdoor, enabling Chinese authorities to track transactions and identify those undertaking them, discouraging use by third parties. Given this, it's hard to see China's digital currency as a game changer internationally.

So, the decision to create a digital dollar would have to be justified on other grounds. The soundest justification is financial inclusion. Americans without credit cards and bank accounts, who rely entirely on cash, are denied not just financial services but other services as well. Rideshare companies ask you to link your app to your credit or debit card; no card, no pick-up. And no bank account, no card.

In this context, recall the difficulty the US Treasury had in getting pandemic relief checks to the unbanked. If everyone had a Federal Reserve-issued electronic wallet into which digital dollars could be deposited, this problem would be solved.

Digital dollars could also address the exorbitant cost of cross-border money transfers. But foreign governments might be reluctant to permit their nationals to install the Fed's digital wallet, because that would leave them and their central banks unable to enforce their capital controls, which they value as macroprudential tools.

Alternatively, the Fed's digital wallet could be made interoperable with foreign digital wallets. But interoperability would require close cooperation between central banks on the details of technology and security. While there are efforts in this direction, making it work would be a daunting task, to say the least.

Ultimately, such advantages should be weighed against the costs and risks of digitizing the dollar. If people shift their savings from banks to digital wallets, banks' ability to lend will be hamstrung. Some banks will close, and small businesses that rely on banks for credit will have to look elsewhere.

Moreover, a Fed-run network of retail payments would be a rich target for hackers and digital terrorists. Security and financial stability are of the essence, and it is not obvious that they can be guaranteed. All this is to say that while the case for a digital dollar may be worthy of examination by Yellen and Powell, it is hardly a slam-dunk.

## "WHY CENTRAL BANK DIGITAL CURRENCIES WILL DESTROY CRYPTOCURRENCIES"

(Project Syndicate – November 19, 2018)



**Nouriel Roubini**, Professor of Economics at New York University's Stern School of Business and Chairman of Roubini Macro Associates, was Senior Economist for International Affairs in the White House's Council of Economic Advisers during the Clinton Administration. He has worked for the International Monetary Fund, the US Federal Reserve, and the World Bank. His website is [NourielRoubini.com](http://NourielRoubini.com), and he is the host of [NourielToday.com](http://NourielToday.com).

*Leading economic policymakers are now considering whether central banks should issue their own digital currencies, to be made available to everyone, rather than just to licensed commercial banks. The idea deserves serious consideration, as it would replace an inherently crisis-prone banking system and close the door on crypto-scammers.*

NEW YORK – The world's central bankers have begun to discuss the idea of central bank digital currencies (CBDCs), and now even the International Monetary Fund and its managing director, Christine Lagarde, are talking openly about the pros and cons of the idea.

This conversation is past due. Cash is being used less and less, and has nearly disappeared in countries such as Sweden and China. At the same time, digital payment systems – PayPal, Venmo, and others in the West; Alipay and WeChat in China; M-Pesa in Kenya; Paytm in India – offer attractive alternatives to services once provided by traditional commercial banks.

Most of these fintech innovations are still connected to traditional banks, and none of them rely on cryptocurrencies or blockchain. Likewise, if CBDCs are ever issued, they will have nothing to do with these over-hyped blockchain technologies.

Nonetheless, starry-eyed crypto-fanatics have seized on policymakers' consideration of CBDCs as proof that even central

banks need blockchain or crypto to enter the digital-currency game. This is nonsense. If anything, CBDCs would likely replace all private digital payment systems, regardless of whether they are connected to traditional bank accounts or cryptocurrencies.

As matters currently stand, only commercial banks have access to central banks' balance sheets; and central banks' reserves are already held as digital currencies. That is why central banks are so efficient and cost-effective at mediating interbank payments and lending transactions. Because individuals, corporations, and non-bank financial institutions do not enjoy the same access, they must rely on licensed commercial banks to process their transactions. Bank deposits, then, are a form of private money that is used for transactions among non-bank private agents. As a result, not even fully digital systems such as Alipay or Venmo can operate apart from the banking system.

By allowing any individual to make transactions through the central bank, CBDCs would upend this arrangement, alleviating the need for cash, traditional bank accounts, and even digital payment services. Better yet, CBDCs would not have to rely on public "permission-less," "trustless" distributed ledgers like those underpinning cryptocurrencies. After all, central banks already have a centralized permissioned private non-distributed ledger that allows for payments and transactions to be facilitated safely and seamlessly. No central banker in his or her right mind would ever swap out that sound system for one based on blockchain.

If a CBDC were to be issued, it would immediately displace cryptocurrencies, which are not scalable, cheap, secure, or actually decentralized. Enthusiasts will argue that cryptocurrencies would remain attractive to those who wish to remain anonymous. But, like private bank deposits today, CBDC transactions could also be made anonymous, with access to account-holder information available, when necessary, only to law-enforcement authorities or regulators, as already happens with private banks. Besides, cryptocurrencies like Bitcoin are not actually anonymous, given that individuals and organizations using crypto-wallets still leave a digital footprint. And authorities that legitimately want to track criminals and terrorists will soon crack down on attempts to create crypto-currencies with complete privacy.

Insofar as CBDCs would crowd out worthless cryptocurrencies, they should be welcomed. Moreover, by transferring payments from private to central banks, a CBDC-based system would be a boon for financial inclusion. Millions of unbanked people would have access to a near-free, efficient payment system through their cell phones.

The main problem with CBDCs is that they would disrupt the current fractional-reserve system through which commercial banks create money by lending out more than they hold in liquid deposits. Banks need deposits in order to make loans and investment decisions. If all private bank deposits were to be moved into CBDCs, then traditional banks would need to become "loanable funds intermediaries," borrowing long-term funds to finance long-term loans such as mortgages.

In other words, the fractional-reserve banking system would be replaced by a narrow-banking system administered mostly by the central bank. That would amount to a financial revolution – and one that would yield many benefits. Central banks would be in a much better position to control credit bubbles, stop bank runs, prevent maturity mismatches, and regulate risky credit/lending decisions by private banks.

So far, no country has decided to go this route, perhaps because it would entail a radical disintermediation of the private banking sector. One alternative would be for central banks to lend back to private banks the deposits that moved into CBDCs. But if the government was effectively banks' only depositor and provider of funds, the risk of state interference in their lending decisions would be obvious.

Lagarde, for her part, has advocated a third solution: private-public partnerships between central banks and private banks. "Individuals could hold regular deposits with financial firms, but transactions would ultimately get settled in digital currency between firms," she explained recently at the Singapore Fintech Festival. "Similar to what happens today, but in a split second." The advantage of this arrangement is that payments "would be immediate, safe, cheap, and potentially semi-anonymous." Moreover, "central banks would retain a sure footing in payments."

This is a clever compromise, but some purists will argue that it would not solve the problems of the current fractional-reserve banking system. There would still be a risk of bank runs, maturity mismatches, and credit bubbles fueled by private-bank-created money. And there would still be a need for deposit insurance and lender-of-last-resort support, which itself creates a moral hazard. Such issues would need to be managed through regulation and bank supervision, and that wouldn't necessarily be enough to prevent future banking crises.

In due time, CBDC-based narrow banking and loanable-funds intermediaries could ensure a better and more stable financial system. If the alternatives are a crisis-prone fractional-reserve system and a crypto-dystopia, then we should remain open to the idea.

## **“THE BITCOIN LOTTERY”** (Project Syndicate – March 8, 2018)



**Jim O'Neill**, a former chairman of Goldman Sachs Asset Management and a former UK treasury minister, is Chair of Chatham House.

*The sudden rise of "special purpose acquisitions companies" and cryptocurrencies speaks less to the virtues of these vehicles than to the excesses of the current bull market. In the long term, these assets will mostly fall into the same category as speculative "growth stocks" today.*

LONDON – I was recently approached about setting up my own “special purpose acquisition company” (SPAC), which would allow me to secure financial commitments from investors on the expectation that I will eventually acquire some promising business that would prefer to avoid an initial public offering. In picturing myself in this new role, I mused that I could be doubly fashionable by also jumping into the burgeoning field of cryptocurrencies. There have been plenty of headlines about striking it big, quickly, so why not get in on the action?

Being a wizened participant in financial markets, I declined the invitation. The rising popularity of SPACs and cryptocurrencies seems to reflect not their own strengths but rather the excesses of the current moment, with its raging bull market in equities, ultra-low interest rates, and policy-driven rallies after a year of COVID-19 lockdowns.

To be sure, in some cases, pursuing the SPAC route to a healthy return probably makes a lot of sense. But the fact that so many of these entities are being created should raise concerns about looming risks in the surrounding markets.

As for the cryptocurrency phenomenon, I have tried to remain open-minded, but the economist in me struggles to make sense of it. I certainly understand the conventional complaints about the major fiat currencies. Throughout my career as a foreign-exchange analyst, I often found that it was much easier to dislike a given currency than it was to find one with obvious appeal.

I can still remember my thinking during the run-up to the introduction of the euro. Aggregating individual European economies under a shared currency would eliminate a key source of monetary-policy restraint – the much-feared German Bundesbank – and would introduce a new set of risks to the global currency market. This worry led me (briefly) to bet on gold. But by the time the euro was introduced in 1999, I had persuaded myself of its attractions and changed my view (which turned out to be a mistake for the first couple of years, but not in the long term).

Similarly, I have lost count of all the papers I have written and read on the supposed unsustainability of the US balance of payments and the impending decline of the dollar. True, these warnings (and similar portents about Japan’s long-running experiment in monetary-policy largesse) have yet to be borne out. But, given all this inductive evidence, I can see why there is so much excitement behind Bitcoin, the modern version of gold, and its many competitors. Particularly in developing and “emerging” economies, where one often cannot trust the central bank or invest in foreign currencies, the opportunity to stow one’s savings in a digital currency is obviously an inviting one.

By the same token, there has long been a case to be made for creating a new world currency – or upgrading the International Monetary Fund’s reserve asset, special drawing rights – to mitigate some of the excesses associated with the dollar, euro, yen, pound, or any other national currency. For its part, China has already introduced a central bank digital currency, in the hopes of laying the foundation for a new, more stable global monetary system.

But these innovations are fundamentally different from a cryptocurrency like Bitcoin. The standard economic textbook view is that for a currency to be credible, it must serve as a means of exchange, a store of value, and a unit of account. It is hard to see how a cryptocurrency could meet all three of these conditions all of the time. True, some cryptocurrencies have demonstrated an ability to perform some of these functions some of the time. But the price of Bitcoin, the canonical cryptocurrency, is so volatile that it is almost impossible to imagine it becoming a reliable store of value or means of exchange.

Moreover, underlying these three functions is the rather important role of monetary policy. Currency management is a key macroeconomic policymaking tool. Why should we surrender this function to some anonymous or amorphous force such as a decentralized ledger, especially one that caps the overall supply of currency, thus guaranteeing perpetual volatility?

At any rate, it will be interesting to see what happens to cryptocurrencies when central banks finally start raising interest rates after years of maintaining ultra-loose monetary policies. We have already seen that the price of Bitcoin tends to fall

sharply during “risk-off” episodes, when markets suddenly move into safe assets. In this respect, it exhibits the same behavior as many “growth stocks” and other highly speculative bets.

In the interest of transparency, I did consider buying some Bitcoin a few years ago, when its price had collapsed from \$18,000 to below \$8,000 in the space of around two months. Friends of mine predicted that it would climb above \$50,000 within two years – and so it has.

Ultimately, I decided against it, because I had already taken a lot of risk investing in early-stage companies that at least served some obvious purpose. But even if I had bet on Bitcoin, I would have understood that it was just a speculative punt, not a bet on the future of the monetary system.

Speculative bets do of course sometimes pay off, and I congratulate those who loaded up on Bitcoin early on. But I would offer them the same advice I would offer to a lottery winner: Don’t let your windfall go to your head.

## “SCHRÖDINGER’S BITCOIN” (Project Syndicate – February 12, 2021)



**Willem H. Buiter** is Visiting Professor of International and Public Affairs at Columbia University.

*Notwithstanding the recent spectacular surge in its price, Bitcoin will remain an asset without intrinsic value whose market value can be anything or nothing. Only those with healthy risk appetites and a robust capacity to absorb losses should consider investing in it.*

NEW YORK – On February 8, Elon Musk’s electric-car firm Tesla announced that it had invested \$1.5 billion of its cash reserves in Bitcoin back in January. The news helped to boost the cryptocurrency’s already skyrocketing price by a further 10%, to a record high of more than \$44,000. But, especially in Bitcoin’s case, what goes up can just as easily come crashing down.

Bitcoin was invented in 2008 and began trading in 2009. In 2010, the value of a single Bitcoin rose from around eight-hundredths of a cent to eight cents. In April 2011, it traded at 67 cents, before subsequently climbing to \$327 by November 2015. As recently as March 20 last year, Bitcoin traded at about \$6,200, but its price has since increased more than sevenfold.

Today, Bitcoin is a perfect, 12-year-old bubble. I once described gold as “shiny Bitcoin,” and characterized the metal’s price as a 6,000-year-old bubble. That was a bit unfair to gold, which used to have intrinsic value as an industrial commodity (now largely redundant), and still does as a consumer durable widely used in jewelry.

Bitcoin, by contrast, has no intrinsic value; it never did and never will. It is a purely speculative asset – a private fiat currency – whose value is whatever the markets say it is.

But Bitcoin is also a socially wasteful speculative asset, because it is expensive to produce. The cost of “mining” an additional Bitcoin – solving computational puzzles using energy-intensive digital equipment – increases at such a rate that the total stock of the cryptocurrency is capped at 21 million units.

Of course, even if Bitcoin’s protocol is not changed to allow for a larger supply, the whole exercise can be repeated through the issuance of Bitcoin 2, Bitcoin 3, and so on. The real costs of mining will thus be replicated, too. Moreover, there are already well-established cryptocurrencies – for example, Ether – operating in parallel with Bitcoin.

But as the success of government-issued fiat currencies shows, the universe of speculative bubbles is by no means restricted to cryptocurrencies like Bitcoin. After all, in a world with flexible prices, there is always an equilibrium where everyone believes the official fiat currency has no value – in which case it consequently has no value. And there are infinitely many “non-fundamental” equilibria where the general price level – the reciprocal of the fiat currency’s price – either explodes and goes to infinity or implodes and falls to zero, even when the money stock remains fairly steady or does not change at all.

Finally, there is the unique “fundamental” equilibrium at which the price level (and the value of the currency) is positive and neither explodes nor implodes. Most government-issued fiat currencies appear to have stumbled into this fundamental equilibrium and stayed there. Keynesians ignore these multiple equilibria, viewing the price level (and thus the price of money) as uniquely determined by history and updated gradually through a mechanism like the Phillips curve, which posits

a stable and inverse relationship between (unexpected) inflation and unemployment.

Regardless of which perspective one adopts, real-world hyperinflations – think of Weimar Germany or the recent cases of Venezuela and Zimbabwe – that effectively reduce the value of money to zero are examples not of non-fundamental equilibria, but rather of fundamental equilibria gone bad. In these cases, money stocks exploded, and the price level responded accordingly.

Private cryptocurrencies and public fiat currencies have the same infinite range of possible equilibria. The zero-price equilibrium is always a possibility, as is the unique, well-behaved fundamental equilibrium.

Bitcoin clearly is exhibiting neither of these equilibria at the moment. What we have instead appears to be a variant of a non-fundamental explosive price equilibrium. It is a variant because it must allow for Bitcoin to make a possible, if unexpected, jump from its current explosive price trajectory to either the nice fundamental equilibrium or the not-so-nice zero-price scenario. This multiple-equilibrium perspective doubtless makes it appear risky to invest in intrinsically valueless assets like Bitcoin and other private cryptocurrencies.

The real world is of course not constrained by the range of possible equilibria supported by the mainstream economic theory outlined here. But that makes Bitcoin even riskier as an investment.

Tesla's recent Bitcoin buy-in shows that a large additional buyer entering the market can boost the cryptocurrency's price significantly, both directly (when markets are illiquid) and indirectly through demonstration and emulation effects. But an exit by a single important player would likely have a similar impact in the opposite direction. Positive or negative opinions voiced by market makers will have significant effects on Bitcoin's price.

The cryptocurrency's spectacular price volatility is not surprising. Deeply irrational market gyrations like the one that drove GameStop's share price to unprecedented highs in January (followed by a significant correction) should serve as a reminder that, lacking any obvious fundamental value anchor, Bitcoin is likely to remain a textbook example of excess volatility.

This will not change with time. Bitcoin will continue to be an asset without intrinsic value whose market value can be anything or nothing. Only those with healthy risk appetites and a robust capacity to absorb losses should consider investing in it.

## “CRYPTOCURRENCIES’ TIME TO SHINE?” (Project Syndicate – April 8, 2020)



**Brian Armstrong** is the co-founder and CEO of Coinbase, a leading cryptocurrency exchange based in San Francisco.

*Now that the COVID-19 pandemic has accelerated the trend toward e-commerce, policymakers and the general public should apprise themselves of the latest developments in cryptocurrencies. And just as e-commerce requires encryption to protect personal privacy, so do digital coins.*

SAN FRANCISCO – Even as all of humanity mobilizes against COVID-19, thoughts are turning to how the world will be different after the crisis. As businesses rush to adapt to the new world of social distancing, the pandemic has accelerated an already inexorable trend toward digital commerce. This broader shift should also include the widespread adoption of digital currencies, which provide stronger consumer financial and privacy protections.

For most of the twentieth century, encryption was reserved for national-security needs. Cryptography helped the Allies win World War II, and then protected secret communications during the Cold War. Until as recently as 1992, the United States, as a matter of national security, did not allow cryptographic technology to be exported. Encrypted communication was not widely available, and anyone using it was assumed to have something to hide.

But starting in the 1990s, early Internet entrepreneurs began calling for encryption to be used in e-commerce, arguing that



it was needed in order to protect customer credit card numbers, passwords, and other information entered online. It turned out that the same encryption technology that had been created in academic labs – where trust and collaboration reigned – could be useful to everyone.

US policymakers and law enforcement initially balked at this push toward widespread encryption. In their view, privacy for everyone meant privacy for terrorists, drug dealers, and money launderers. As FBI Director Louis J. Freeh told Congress in 1994, preserving the US government’s ability to intercept Internet communications was “the No. 1 law enforcement, public safety, and national security issue facing us today.”

The debate about end-to-end encryption is still raging. But, crucially, consumer expectations have changed since the 1990s. The overwhelming majority of Internet traffic is now encrypted, and most of us have been trained to look for the closed-lock icon in our browser before entering sensitive information. Popular apps like WhatsApp, Telegram, iMessage, and Signal have led the way in normalizing private messaging that can’t be tracked by third parties.

But there is one area of our lives where privacy is not yet the norm: our personal financial information. By law, financial firms are required to collect reams of personal information about their customers. This information ultimately ends up on online databases, where it presents a tempting target for hackers. In 2017, the credit-rating firm Equifax revealed that a data breach had exposed sensitive information about more than 147 million consumers, or just under half the US population. That followed a similar breach in 2013, when hackers famously obtained the names, credit card numbers, and other information about tens of millions of Target customers.

Fortunately, a solution is on the horizon. Cryptocurrencies hold the promise of creating a more open financial system, with worldwide access, instantaneous fund transfers, lower costs, and vastly improved consumer-privacy protections. When Bitcoin first gained popularity, many people incorrectly assumed that it was anonymous money. In fact, as a blockchain technology, it uses a public ledger that records a digital trail of every transaction. Blockchain analytics firms are thus now helping law enforcement track down criminals who thought their trail was covered. And cryptocurrency exchanges like Coinbase have instituted robust anti-money-laundering and know-your-customer programs that rival those of any financial institution.

Several more recent developments in cryptocurrency technologies promise to take consumer privacy to even higher levels, and they are sure to be controversial. First, “privacy coins” such as Zcash and Monero offer new cryptocurrency protocols that make every transaction untraceable. Other cryptocurrencies aspire to replicate these features, and even JP Morgan has explored private transactions through its Quorum cryptocurrency. This shift is a bit like when websites moved from HTTP to HTTPS as the global standard: it lets consumers know that their information is protected by default.

Second, so-called non-custodial cryptocurrency wallets now enable customers to store their own private keys (which allow one to move funds) instead of relying on a third party. By not actually storing customer funds, the providers of non-custodial wallets are aiming to position themselves as software companies rather than financial institutions subject to regulation. In the past, non-custodial wallets required a certain degree of technical sophistication to operate, limiting their use. But, like encrypted messaging apps, they are becoming increasingly accessible to a mass market.

Unsurprisingly, these innovations have alarmed banks, regulators, and law-enforcement agencies. But just as the early Internet needed encryption to enable digital commerce, cryptocurrencies need privacy protections to unlock their full power and potential. Whether one needs to guard against authoritarian regimes, data harvesters, or criminals, the best way to ensure that sensitive financial data isn’t hacked is to avoid having to collect it in the first place.

Enhancing consumer financial protections does not mean giving free rein to criminals. Law-enforcement agencies still have a wide range of tools at their disposal, from subpoenaing cryptocurrency exchanges to examining conversions into and out of fiat currencies (which are likely to remain the choke points for law enforcement). And these exchanges will continue to be regulated as financial services, regardless of whether consumers are using privacy coins or non-custodial wallets.

Having watched the US benefit enormously from the creation of the world’s leading Internet companies, many countries are now working to attract the next generation of cryptocurrency firms. For countries thinking about cryptocurrency policy, the best approach, as always, will be to strike a balance between law enforcement, cybersecurity, privacy, innovation, and economic competitiveness.

Consumers in a free society will always demand and expect reasonable levels of privacy. Our financial lives are no exception. Fortunately, cryptocurrencies can fix some of the most vexing issues in financial services. As we plan to rebuild economically after the COVID-19 crisis, we must allow these technologies to grow.

## “THE RIGHT RESPONSE TO THE LIBRA THREAT” (Project Syndicate – August 5, 2019)



**Katharina Pistor**, Professor of Comparative Law at Columbia Law School, is the author of *The Code of Capital: How the Law Creates Wealth and Inequality*.



**Co-Pierre Georg**, an associate professor at the University of Cape Town School of Economics, holds the South African Reserve Bank Research Chair in Financial Stability Studies..

*Facebook's plans for a digital currency and payments system have understandably been met with skepticism, bordering on outrage. Clearly, if a serial violator of the public trust can unilaterally insinuate itself into the global monetary system, something must be done to manage the rise of digital private monies.*

NEW YORK – Facebook’s plan to launch a new digital currency, Libra, within a year has won few friends. Regulators, policymakers, and academics reacted to the news swiftly, and for the most part skeptically. US congressional committees quickly arranged hearings, and the issue featured prominently at the G7 meeting in France last month.

Facebook’s disrepute as a guardian of user privacy helps to explain some of the blowback. The real bombshell, however, was the sudden realization of the threat posed by digital currencies to the existing monetary system – not at some later date, but right now. Cryptocurrencies have been around for over a decade, but none has been adopted widely enough to challenge the existing order. With the potential to mobilize more than two billion monthly active users, Facebook could change that.

Now that the company has thrown down the gauntlet, governments should use the opportunity to advance a form of digital currency that serves the public good. Even the staunchest defenders of the current monetary system will admit that it does not work equally well for everyone. Moreover, the system is being rapidly outpaced by technological change, much of which is insufficiently regulated and could expose consumers to unforeseen risks.

It doesn’t have to be this way. Technology could enable the development of a far better system. One of the original motivations behind Bitcoin and other cryptocurrencies was to establish an alternative, censorship-resistant payment system. Sweden and Singapore are on track to create central-bank-backed digital currencies (CBDCs) of their own. In China, a handful of companies, including Alibaba and Tencent, have launched closely regulated and supervised digital currencies for transactions that are settled in renminbi. In Kenya, Mali, and elsewhere, phone companies offer digital-payment services to everyone, even those without a bank account.

These experiments offer plenty of models to choose from. But first, we must consider a fundamental question: Should the state allow the creation of private money, or should it tightly limit efforts like Bitcoin and Libra, even at the risk of curtailing innovation?

Money is conventionally defined by the functions it performs: it is a means of exchange, a store of value, and a unit of account. The dollar, pound, yen, and euro each perform all three functions, but not without some help from the private sector. Banks play a critical role in payment systems (the exchange function of money), by issuing private monies in the form of book money and the like. They also offer deposits, which can be viewed as stores of value (assuming they are insured). Only the unit-of-account function – which guarantees a currency’s nominal value as legal tender for paying taxes – is in the hands of the state alone.

Given that some of the defining functions of money can be farmed out to private actors, the question is whether, and to what extent, they should be. Shouldn’t we favor CBDCs over all the different forms of privately issued digital monies? After all, there are powerful normative arguments to be made for CBDCs. As public goods, payment systems should be available on equal terms to everyone. And with modern technologies, we can finally cut out the middlemen (banks) who have been skimming the cream off the top for centuries.

On the other hand, there is also a case to be made against the monopolization of the payment system. Under ideal circumstances, CBDCs could usher in a fully integrated, highly efficient system that works for everyone. But in the real world, even a slight technical glitch or other governance failure could have systemic effects. Generally speaking, monolithic systems lack the resilience of diversified systems, not to mention the incentives for further innovation.

Still, a multiplicity of payment systems comes with problems of its own. The transaction costs of converting diverse currencies, either into one another or into fiat currency, could be enormous. And the history of free banking tells us that unregulated monetary systems are prone to collapse.

This conundrum could be solved by creating a single framework for all digital currencies, which would keep the door open for innovation. Alternatively, it could be addressed through common protocols to govern interoperability among separate systems, similar to how the Internet has evolved.

Either way, we need a new infrastructure for managing both public and private monies. They should be treated as a public good, and thus accessible on a non-profit basis. They should be open to anyone looking to develop specific new products or services, subject to a simple registration requirement. Depending on the service, all offerings should be regulated to ensure the safety and stability of the monetary system. To reduce compliance costs for smaller start-ups, supervisory authorities could provide free consultation about the appropriate regulatory channels for new products. And, where necessary, regulation should be streamlined to avoid unnecessary overlap and other sources of inefficiency.

Digital monies present us with a massive challenge. Traditionally, the guardians of the money system, central banks, have focused narrowly on monetary policy and financial stability. Guiding financial innovation is far outside their existing mandates. But given the pace of change, they may have no choice but to expand their remit sooner rather than later.

## ABOUT THE COUNCIL FOR THE UNITED STATES AND ITALY

The Council for the United States and Italy is a private non-profit organization, founded in Venice in 1983 by Gianni Agnelli and David Rockefeller, who served as honorary presidents until 2003. Marco Tronchetti Provera followed them as Chairman, then Sergio Marchionne until 2018. Domenico Siniscalco is the current Chairman, Gianni Riotta Executive Vice Chairman. The Council for the United States and Italy promotes and creates economic relations between Italy and the United States, linking them to Europe, Asia and Africa through knowledge and free trade. Its members are leaders in the economy, industry, finance, technology, services, consulting, law and culture - a team in which economic growth is viewed as promoting humanity and wealth as a cultural value to be shared.

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