

European Parliament | Brussels, 28 June 2018

Committee on Economic and Monetary Affairs: Monetary Dialogue Preparatory Meeting

Virtual Currencies

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- Money = generally accepted means of exchange
 - » store of value
 - » unit of account } subordinate, non-constitutive characteristics

- Money once emerged as a product of the free market

- Money constitutes a good category sui generis
 - » No consumption good (no direct satisfaction of human needs)
 - » No production factor (productivity does not depend on its quantity)

- ⇒ **Global network good: Optimal currency area = world**
(if not used as policy tool for macro-interventions)

- Commodity money
 - » Money proper (coins)
 - » Money certificates (fully covered notes and demand deposits)
 - ⇒ Competitive issuance, no need for central coordination

- Monopolization of money
 - » Legal tender rules
 - » Fiat money
 - ⇒ Lower transaction costs, but risk of excessive money production

- **Today: Public-private partnership**
 - » Central banks (public part) and commercial banks (private part)
 - » Fractional reserve banking: High elasticity of money and credit creation (financial intermediation and credit creation)
 - ⇒ **Inherent instability requires comprehensive regulation**

- New players
 - » Currency competition via private digital money
 - » Issuers beyond the banking sector
 - Newcomers: Bitcoin, Ethereum, ...
 - Network incumbents: Google, Microsoft, Amazon, Apple, Facebook, ...
 - Challenge: Boosting general acceptance
 - » Reputation building, promoting initial stability (regression theorem, Mises)
 - » Peg to existing fiat money: No new money, legal tender regulations
 - » Physical reserve media or basket of goods: Global free banking
- ⇒ **Potential competition (digital money as an option) may limit the conduct of monetary policy (Hayek 1976/1978).**

Experimenting around with parallel currencies

- Currency competition
 - » Money: Network good, but not mutually exclusive (unlike right-hand vs. left-hand traffic)
 - » Traditional and new forms of money can coexist
 - » Heavily facilitated by digital technologies

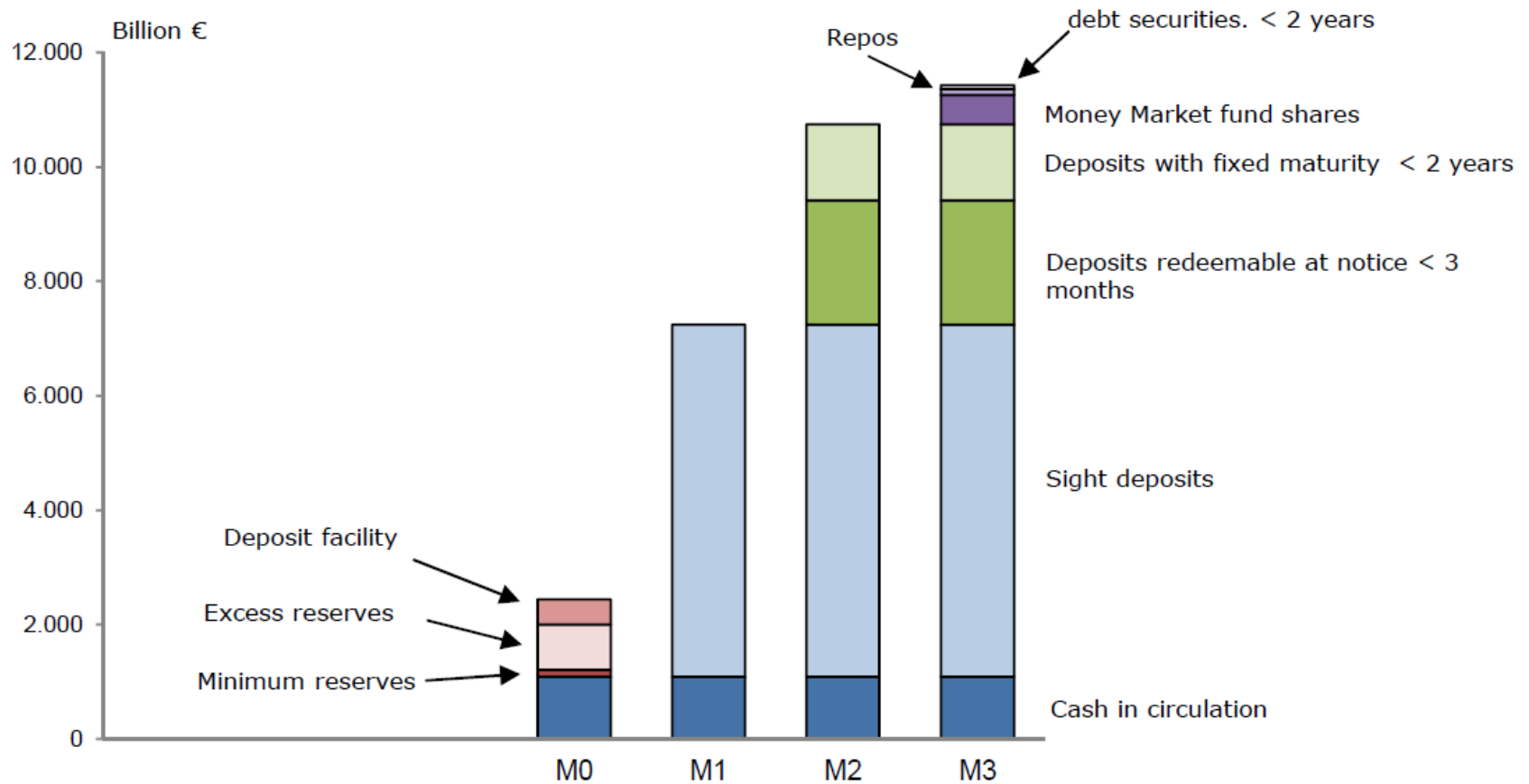
- Crypto currencies
 - » Special form of digital currencies (pseudonymous, not anonymous)
 - » May or may not be backed with reserve medium
 - » No need for central ledger
 - » Global from the start
 - » Current performance problems (in terms of transaction volumes) likely to be overcome by technological innovations

⇒ **Extended scope for monetary experiments**

- “Fedcoins” (CBDC, central bank digital currency)
 - » Non-cash high powered money circulating in non-financial sector
 - » Central bank money accounts for everyone

 - Challenging the present fractional reserve system at its core
 - » Short-run impact on commercial banks may be similar to a bank run
 - » Trend towards fewer maturity transformation
 - » Sharp increase of base money, higher seignorage gains for CB
 - » Lower elasticity of money and credit creation
 - » If parallel to fractional reserve banking: Higher risks of pro-cyclical shifts between bank deposits and Fedcoins
- ⇒ **Drift towards 100-percent banking (Chicago Plan 2.0)?**

Money aggregates in the euro area (Jan. 2017)



Data source: European Central Bank.

Technically

Relaxing the lower zero bound for monetary policy

BUT

Market participants in search for reliable means of exchange since the beginning of the monetary era

Increased potential competition from private e-currencies leaves central banks with less room for maneuver

Impact of virtual currencies:

**Good news for those
who see money primarily as an exchange facilitator**

**Bad news for those
who believe in monetary policy as a macro-management tool**

Feedback welcome

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