With Digital Currency, Regulators Should Let Markets Pick Winners

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Launched in 1989, Digicash introduced the first cryptocurrency. In the 1990s, it was considered leading-edge payments technology. But physical and digital currencies are payment networks. In payment systems, good technology is neither sufficient nor generally the biggest hurdle. No matter how good the technology, without critical mass they're worth little.

Digicash wasn't able to build a critical mass of banks, consumers, and merchants. Moreover, enabling fiat currencies to be privately exchanged didn't solve a burning problem for licit e-commerce. While Digicash was technically elegant and putatively more secure, credit cards were good enough. It went belly-up in 1998.

E-gold debuted in 1996. Users exchanged digital tokens representing gold ownership. The network earned transaction fees. By 2006, it was active in over 100 countries and doing the equivalent of $3 billion in payment volume. However, notwithstanding its actively collaborating with law enforcement to nab criminals using e-gold, the Secret Service and FBI raided founder Doug Jackson's home and office in 2005.

In 2007, Jackson, his companies, and partners were charged with operating an unlicensed money-transmitter business and conspiring to money launder. In 2009, E-gold threw in the towel.

That same year, Bitcoin went live. Bitcoin transformed how the world thinks about cryptocurrencies. Its soaring market capitalization, at $1.1 trillion, is socializing cryptocurrencies as an asset class. They're not, however, yet fit for purpose, as payment systems like Mastercard, Visa, Zelle, the dollar, and euro are.

But public and private digital fiat currencies that will compete as payment systems are coming.

Their technology and legal instrument must be good enough. They also need compelling use cases and a path to network critical mass, and, therefore, value and relevance. That’s dependent on user incentives, trust, the business model, the backers, and conducive competitive and regulatory ecosystems.

Central banks are exploring electronic fiat currencies. The digital yuan and Facebook’s 2019 Libra (now Diem) announcement accelerated the Fed’s interest.

But the market isn’t waiting.

Niche dollar-backed stablecoins like Tether’s USDT and Circle’s USDC operate over multiple blockchains. Tether issued its first stablecoin in 2014. USDT has the highest stablecoin market capitalization at $42 billion. It’s sold as 100% backed by dollars. There are also gold-, euro-, and yuan-backed Tether stablecoins. One of USDT’s primary use cases is trading Bitcoin.

Finance professor John Griffin and economist Amin Shams studied Bitcoin and Tether transactions. In **“Is Bitcoin Really Un-Tethered?”** , they reported results “generally consistent with Tether being printed unbacked and pushed out onto the market, which can leave an inflationary effect” on Bitcoin on other cryptocurrencies’ prices. They note, “In a May 15, 2019 court hearing, a Bitfinix attorney also admitted Tether did invest in instruments beyond cash, including Bitcoin, something clearly at odds with Tether’s longstanding claims.” New York’s Attorney General, Letitia James was blunter. In February, she declared, “Tether’s claims that its virtual currency was fully backed by U.S. dollars at all times was a lie.” Stablecoins, like Caesar’s wife, must be above suspicion. They should err on the side of too much transparency.

The number-two stablecoin, Circle’s USDC, has a $10-billion market cap. Circle has raised $246 million since its 2013 founding. Its protocols are supported by the Centre Consortium, which it founded with Coinbase in 2018. The standard is global.

But the giant that in 2019 provoked a firestorm from regulators and politicians hasn't yet stepped into the arena. Diem Coin could be the spark needed to ignite cryptocurrencies as mainstream payment instruments. The Diem Association is staffing up. A dollar-backed stablecoin, Diem could debut this year.

Curating an ecosystem of wallets and cryptocurrency platforms to facilitate use is essential. But it's Facebook's Novi Financial, the association's first-among-equals member, that has the potential to catapult Diem into the digital-currency pole position. That's if the social-media giant successfully promotes its use on and off platform.

Today, we use two-tier central- and commercial-bank liability money. In practice, the majority of consumer and business payments are in commercial, not central-bank, money. For much of U.S. history, banks issued dollar banknotes. Banks could join the mix issuing interoperable fiat-currency-backed stablecoins, using The Clearing House, Mastercard, and/or Visa as clearing houses.

However, they have cause to tread cautiously. Digital fiat currencies won't only compete with cash but also with banks' lucrative credit and debit cards, and with their person-to-person and interbank payment systems. Moreover, for many purposes, digital currencies may be inferior to existing electronic payment systems offering widespread acceptance, fraud protection, repudiation rights, record keeping, and other benefits. Compelling mainstream digital-currency use cases and business model(s) have yet to be demonstrated.

Mastercard and Visa have trumpeted limited cryptocurrency support. While such ventures could cannibalize traditional "card" payments, the global networks could generate fees processing private and public stablecoins. They already support their licensees' fiat-currency debit cards attached to assets like Bitcoin and gold.

Open digital wallets enable multiple competing digital currencies to evolve, guided by the choices of billions of consumers, hundreds of millions of businesses, thousands of banks, payment systems, and processors, and hundreds of central banks, planetwide. Aspiring to be consumers' payments and financial dashboard, Apple Pay, Google Pay, PayPal, and others will be motivated to support a range of digital currencies.

No highbrow payments savant at the Bank for International Settlements, European Central Bank, the Fed, PayPal, Mastercard, or Visa, knows what the best digital-currency mousetrap will be. Policymakers should allow ample space for competing public and private models to iterate in the market.