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What if the Bitcoin End Game is a Digital Dollar?

By Michael J. Casey



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Lost your taste for bitcoin? News of bankrupt exchanges losing hundreds of millions of customers' dollars, worldwide hacking attacks and drug-related arrests can do that to you.



Horizons

By Michael J. Casey

COMMENTARY

Well, might I interest you in some bit-bucks instead? You can call them e-backs, if you like, or digital dollars.

Despite the triumphalism of bitcoin's naysayers this past week, crypto-currencies aren't doomed. You can't suppress an innovation that permits global, low-cost peer-to-peer transactions and which renders obsolete the rent-seeking intermediaries of a cumbersome international payments system. It's just that for all bitcoin's quirky charms, it might not be the best driver for this technology.

So, where does this process go?

It's a ways off, but the end game could be the digitalization of fiat currencies, those creaky government-backed forms of paper money that bitcoin vows to disrupt. If so, get ready for a new world order.

A digital dollar would alarm crypto-currency enthusiasts who see privately developed digital currencies—backed not by a government but by consensus-building networks of computer owners—as an escape from the curse of paper currencies. They warn that profligate politicians and self-interested bankers habitually debase national currencies and lump citizens with the bill by way of inflation, lost purchasing power and unaccountable government.

However, Average Joes are now also looking warily at these techies' newfangled alternatives—evident in the comments stream on stories about last week's collapse of bitcoin exchange Mt. Gox. Ordinary folk have been burned by both Washington and Wall Street, but at least they understand those animals, or think they do. How are they to trust a complicated collection of bits and bytes that's "mined" by a network of anonymous computers and exploited by geeks via offshore, unregulated and highly unstable exchanges? Above all, money is about trust.

Still, mind-blowing new digital-currency ideas seem to arrive daily, [bitcoin-based sales are growing steadily](#), and serious institutional investors are [unveiling plans for large-scale, regulated exchanges](#).

Financial innovation is unstoppable, which means society is headed for a showdown. It will pit the innovators, armed with a technology that promises to slash costs and integrate billions of human beings into a more efficient global financial system, against the likes of Sen. Joe Manchin (D-W. Va.), who wants to ban bitcoin. Inevitably, governments will negotiate a compromise. And it could be that they actually join the crypto-currency revolution.

Canada is already experimenting with a digital version of its dollar, the so-called MintChip. But the real game-changer would be a digital U.S. dollar.

And if that becomes entrenched, "national borders are not going to have much meaning anymore," says Cornell professor and former IMF economist Eswar Prasad.

If their citizens can obtain and use a digital version of the world's most sought-after currency by clicking a mouse, countries like China, Russia and Argentina will find it harder to insulate their financial systems with capital controls. They'd try to censor the Internet or ban access to foreign currency, but the digital dollar would eventually seep in to supplant the yuan, ruble or peso for internal and external commerce.

"The walls that countries try to put up around capital inflows and outflows, those are going to disappear very, very quickly," said Mr. Prasad, whose new book, "The Dollar Trap," explains how the greenback came to dominate the global economy.

And that's not all. Central banks could use digital fiat currencies to get around the "zero-bound" problem that forced them into massive money-printing programs once they'd cut interest rates to zero after the 2008 financial crisis, says Mr. Prasad. If digital currencies were to fully replace their paper equivalents, he adds, central banks could tax bank accounts—effectively setting a negative rate—since depositors could no longer flee the taxman by storing dollars under the mattress.

For sure, the idea of an all-powerful central bank literally cutting your savings is horrendous for those who trumpet bitcoin's independence. But it is arguably preferable to endless "quantitative easing" programs, which have lined the pockets of financiers but failed to create jobs for tens of millions.

Right now, interest rates below inflation are already eroding the dollar's spending power. But although that's effectively the same as nominally reducing savings, households and businesses typically don't perceive the same loss of value, making it harder for central banks to incentivize spending, stimulate the

economy and create jobs. And inflation is unevenly distributed across society. Negative interest rates would be a fairer and more effective tool.

“If your money is literally eroding, there is a very powerful incentive to use it,” says Mr. Prasad.

Still, if you don’t trust the Federal Reserves to make such decisions, this is horrible, right?

Well, the good news for libertarian bitcoiners is that it’s possible to create private, digital alternatives to fiat currencies. In the future, the Fed won’t be held to account by bank lobbyist-funded Congressmen but by a global marketplace in which anyone can issue a competing currency.

Bitcoin’s recent problems have enlivened its critics. But the revolution it unleashed is only just beginning.

– Follow Michael J. Casey on Twitter: [@mikejcasey](https://twitter.com/mikejcasey).

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