

Digital Currencies: Some Potential Implications

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Abstract:

Recent crises in the United States and Europe have made it clear that damaging financial instability is possible even in countries with high incomes, strong legal systems, and enforceable contracts. There is a long list of reform efforts since 2010, including increasing capital requirements, changing the rules for the resolution of failing financial companies, and centralizing derivative markets. Some jurisdictions have also introduced restrictions on banks' activities.

Still, the potential for serious systemic risk persists – and there are fundamental debates about how to reduce this risk on both sides of the Atlantic. In this context, two interrelated ideas hold considerable appeal: that central banks should issue their own digital currency; and that financial transactions more broadly could be organized on a decentralized ledger (i.e., a blockchain). A central bank-issued digital currency would provide the essential safe harbor for transactions balances – money that is not subject to runs. A fully transparent and robust decentralized record of financial transactions could increase accountability and reduce counter-party risk.

An additional challenge in this context is the appearance of privately issued digital money (e.g., Bitcoin). Versions of this could either substitute or complement central bank money. Rapid development of alternative transactions technology is already underway – and there is a real danger that policymakers will fall behind.