Digital Currency *Headache*

By Kenneth Rogoff

Goodbye to the dollar's ability to further national interests.

Facebook CEO Mark Zuckerberg was at least half right when he recently told the United States Congress that there is no U.S. monopoly on regulation of next-generation payments technology. You may not like Facebook's proposed Libra (pseudo) cryptocurrency, Zuckerberg implied, but a state-run Chinese digital currency with global ambitions is perhaps just a few months away, and you will probably like that even less.

Perhaps Zuckerberg went too far when he suggested that the imminent rise of a Chinese digital currency could undermine overall dollar dominance of global trade and finance—at least the large part that is legal, taxed, and regulated. In fact, U.S. regulators have vast power not only over domestic entities but also over any financial firms that need access to dollar markets, as Europe recently learned to its dismay when the United States forced European banks to comply with severe restrictions on doing business with Iran.

America's deep and liquid markets, its strong institutions, and the rule of law will trump Chinese efforts to achieve currency dominance for a long time to come. China's burdensome capital controls, its limits on foreign holdings of bonds and equities, and the general opaqueness of its financial system leave the renminbi many decades away from supplanting the dollar in the legal global economy.

Control over the underground economy, however, is another matter entirely. The global underground economy, consisting mainly of tax evasion and criminal activities, but also terrorism, is much smaller than the

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Kenneth Rogoff is Professor of Economics and Public Policy at Harvard University, and former chief economist of the International Monetary Fund.

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220 I Street, N.E., Suite 200
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www.international-economy.com
editor@international-economy.com

legal economy (perhaps one-fifth the size), but it is still highly consequential. The issue here is not so much whose currency is dominant, but how to minimize adverse effects. And a widely used, state-backed Chinese digital currency could certainly have an impact, especially in areas where China's interests do not coincide with those of the West.

A U.S.-regulated digital currency could in principle be required to be traceable by U.S. authorities, so that if North Korea were to use it to hire Russian nuclear scientists, or Iran were to use it to finance terrorist activity, they would run a high risk of being caught, and potentially even blocked. If, however, the digital currency were run out of China, the United States would have far fewer levers to pull. Western regulators could ultimately ban the use of China's digital currency, but that wouldn't stop it from being used in large parts of Africa, Latin America, and Asia, which in turn could engender some underground demand even in the United States and Europe.

One might well ask why existing cryptocurrencies such as Bitcoin cannot already perform this function. To an extremely limited extent, they do. But regulators worldwide have huge incentives to rein in cryptocurrencies by sharply proscribing their use in banks and retail establishments. Such restrictions make existing cryptocurrencies highly illiquid and ultimately greatly limit their fundamental underlying value. Not so for a Chinese-backed digital renminbi that could readily be spent in one of the world's two largest economies. True, when China announces its new digital currency, it will almost surely be "permissioned": a central clearing house will in principle allow the Chinese government to see anything and everything. But the United States will not.

Facebook's Libra is also designed as a "permissioned" currency, in its case under the auspices of Swiss regulators.

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Cooperation with Switzerland, where the currency is officially registered, will surely be much better than with China, despite Switzerland's long tradition of extending privacy to financial transactions, especially with regard to tax evasion.

The fact that Libra will be pegged to the U.S. dollar will give U.S. authorities additional insight, because (at present) all dollar clearing must go through U.S.-regulated entities. Still, given that Libra's functionality can largely be duplicated with existing financial instruments, it is hard to see much fundamental demand for Libra except among those aiming to evade detection. Unless tech-sponsored currencies offer genuinely superior technology—and this is not at all obvious—they should be regulated in the same way as everyone else.

If nothing else, Libra has inspired many advanced-economy central banks to accelerate their programs to provide broader-based retail digital currencies, and, one hopes, to strengthen their efforts to boost financial inclusion. But this battle is not simply over the profits from printing currency; ultimately, it is over the state's ability to regulate and tax the economy in general, and over the U.S. government's ability to use the dollar's global role to advance its international policy aims.

The U.S. currently has financial sanctions in place against twelve countries. Turkey was briefly sanctioned last month after its invasion of Kurdish territory in Syria, though the measures were quickly lifted. For Russia, sanctions have been in place for five years.

Just as technology has disrupted media, politics, and business, it is on the verge of disrupting America's ability to leverage faith in its currency to pursue its broader national interests. Libra is probably not the answer to the coming disruption posed by government-sanctioned digital currencies from China and elsewhere. But if not, Western governments need to start thinking about their response now, before it is too late. ◆