

# Why Libra passes the money test and bitcoin doesn't

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*Even the Bank of Canada sees promise in stablecoins*



Anyone who bought a bitcoin this past June for \$17,000 is now looking at an asset worth about \$9,000, a clear indication of its uselessness as a store of value. Libra would be different, say experts. Reuters/Dado Ruvic/Illustration/File Photo

Private digital money just doesn't work. Or so say the doubters, and they've been right. Wildly fluctuating cryptocurrencies — bitcoin and thousands of variants — have demonstrated that the miracle of blockchain-driven digital currencies, altcoins, crypto tokens and other forms of electronic cash cannot serve the role of money.

A true currency, as monetary economists have argued for more than a century, must have three core attributes before it can be described and accepted as money: It must be able to serve as a medium of exchange, a store of value and a unit of account, which means something that can be used as a steady measure to track the price and value of products, assets, business transactions, or to establish accounting reports.

Bitcoin fails two of the tests.

Central banking systems, of course, use laws and regulations in an attempt to stabilize their currencies (a.k.a. public money) to meet the three tests.

But although Bitcoins fail as money, Libra could pass the tests, Timothy Lane, deputy governor of the Bank of Canada, said during a digital currency discussion in October at the Institute of International Finance. With the Libra stablecoin model, he said, “you actually do have stability of value, potentially.”

Perhaps the best real-world demonstration of the concept behind the Libra plan is the Hong Kong dollar, which is managed through a currency board structure rather than a formal central bank. Established in 1983, the Hong Kong Monetary Authority issues currency that is fully backed and exchanged, dollar for dollar, though a reserve of U.S. dollars at a fixed rate of around 7.8 HK\$ per US\$.

If the HK\$ exchange rate declines, the monetary authority is legally bound to start buying HK\$ to maintain the 7.8 rate. If the HK\$ rises, the authority must sell HK\$. For every HK\$ in circulation, the authority holds a corresponding reserve of U.S. dollars. In November, the reserve held US\$460-billion.

As a result, the Hong Kong currency has remained rock steady through the mass anti-Communist demonstrations of the last year.

One of the world’s leading currency board experts, Johns Hopkins University monetary economist Steve Hanke, said Facebook’s Libra proposal is “exactly like a currency board.”

Hanke advised Bulgaria on the 1997 establishment of the small European nation’s successful currency board setup. The Bulgarian currency, called the lev, is essentially “a clone of the euro” in the same way the HK\$ is fixed to the US\$. Libra “would be a clone of a basket of currencies” instead of one currency, he said in an interview.

As a currency board operation, every Libra issued by the Libra Association (based in Switzerland) would be fully backed by a reserve of foreign currencies. Hypothetically, the basket could include 80 per cent U.S. dollars, 10 per cent euros, seven per cent Japanese yen and three per cent Canadian dollars.

Hanke added the currency board proposal in the Libra reserve plan may be premature and lack economic rigour, but “there is no problem with Libra.” One of the major potential benefits of a private electronic currency is that it “could wipe out all the crappy central bank currencies in the developing world.”

Facebook Inc. chief executive Mark Zuckerberg told the U.S. House Financial Services Committee that members of the Libra group have met with regulators in 30 countries. The Bank of Canada said it does not disclose meetings with outsiders, but it is almost a certainty that Libra officials have met with Canadian officials, which may explain the bank's supportive views. "We could be one innovation away from something that could be seriously useful — and therefore seriously disruptive," Lane said.

The deputy governor also envisaged the existence of a digital currency issued by the Bank of Canada, known as a Central Bank Digital Currency, assuming the federal government, including Finance Canada, agrees to such a move.

Under that scenario, both Libra and central bank digital money could simultaneously exist, a proposal recommended by associates of Princeton University economist Harold James in "The Digitization of Money," a paper published in August in response to the Libra proposal.

In effect, James and colleagues propose "interoperability" between, say, a Bank of Canada digital dollar and a Libra backed by the technology platform operated by Facebook and associated companies.

In that scenario, central banks would still retain control over monetary policy while private money would provide the platform for payments and currency exchange nationally and globally.

Maybe it is not premature to say "Vive le Libra!"

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