

## **SDR AND BITCOINS: COMPETITION OR COOPERATION?**

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Christine Lagarde - the IMF Managing Director - in her recent speech<sup>1</sup> on the 20<sup>th</sup> anniversary of the Bank of England's independence, wondered whether virtual currencies - like the Bitcoin - pose a challenge to the current system of currencies and central banks.

The answer is that, for the time being, this is not the case because virtual currencies are "too volatile, too risky, too energy intensive [...] many are too opaque for regulators; and some have been hacked". Nonetheless there is a "growing demand for new payment services" in economies "rooted in peer-to-peer transactions, in frequent, small value payment, often cross border": in these cases, virtual currencies can be competitive against traditional systems such as credit cards.

In a world of big data, with new and increasingly sophisticated technologies, capable of handling them, new models of financial intermediation will emerge: we can already see the changes experimented in the consumer credit field and in mortgages.

Bitcoin and other virtual currencies will face issues and difficulties well-known in monetary history: in the face of significant technological advantages - especially in the medium of exchange function - the store of value function could be a bitter surprise to its users that often will - unknowingly - take on expensive risks for their financial assets.

The Gresham's law, for which "bad money drives out good", i.e. the holder tends to get rid of "bad money" and to treasure the "good money" instead, applies also to the virtual currencies. The challenge with the systems subject to the supervision of regulators (central banks and the Bank of England itself appeared just after the collapse of the value of financial assets) hardly will be won by the virtual currencies, that will often leave dead and injured behind them, on the battlefield.

In the payment system, the challenge is more open but, as Mrs Lagarde reminds, citizens might "hold virtual currency rather than physical dollars, euros, [...] because it may one day be easier and safer than obtaining paper bills, especially in remote regions. And because virtual currencies could actually become more stable".

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<sup>1</sup> "Central Banking and Fintech – A brave new world?", Christine Lagarde, IMF Managing Director, Bank of England Conference, London, September 29, 2017

There is, in fact, a condition which is essential in order to have a real dissemination of such payment systems, whose use can find, especially in the international dimension, a strong incentive: they must guarantee the stability of the value of the unit of account in which they are expressed. There is only one way to achieve this: the peg to a currency or rather to a "stable basket of currencies". The link with gold or other real assets would not solve the problem, given the strong fluctuations registered in their prices.

Sooner or later some virtual currency will tend to anchor to a currency or a basket of currencies, which can promise stability in their value, and conquer – again for the Gresham's law - rising market shares to the detriment of unstable virtual currencies. The peg to the SDR is preferable compared to a link to single currencies, assuring greater stability (as the SDR is a basket of currencies), and would also be consistent with the international use of the virtual currencies.

The ability to operate on an international field has always characterized the emergence of new payment systems. This was the case for the rise of letters of credit of wool merchants in the 14<sup>th</sup> century that made Lyon the monetary center of the time, and for the credit card, introduced in the United States last century (1950) because there was no banking system at federal level and payments between the various states were difficult as one could not trust the checks issued by unknown banks of other states.

Citizens everywhere in the world will increasingly buy books, travels, smartphones, etc from worldwide chains, which need to have price lists expressed in stable international units of account: the virtual currency able to win the challenge will be the one able to make these transactions and offer the stability needed.

The "digital version of the SDR" is an ideal candidate and the IMF – as declared by its Managing Director - is open to cooperation.

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