Virtual Currencies and the State
J. Sommer, How is Private Money Possible?

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Whenever I hear about "virtual currency," I check my wallet, or sometimes reach for my revolver. The term is marketing hype: the bastard spawn of financial hucksterism, bro libertarianism, and perverse technophilia.

Fortunately, the organizers of this roundtable have narrowed the term to something useful. They refer to Libra. Libra means something. It implements an old argument by Friedrich Hayek (1990): that private banks could create their own unit of account. There is nothing analytically wrong with this argument. Anybody *can* create their own unit of account. Parker Brothers does so with every game of Monopoly that it sells. The problem is in getting others to accept this new unit of account in some medium of exchange. In other words, the problem is that of creating a monetary community.

The notion of "monetary community" is complex, and this note is short. So I will wave my hands when I hit the rough spots. Or borrow others' hands, such as Abba Lerner's definition of money: "what we use to pay for things." Lerner (1947) at 314. Anything can be money, just as anything can be divine. But both God and Mammon need a practicing community. Simmel (1907) at 179.

Hayek showed that banks could create monetary communities around new units of account. But nobody took him up on his offer. There are indeed new monetary communities. Banks invent most of them, telephone or internet companies some of them, and utopians the rest. But they are all new media of exchange, not units of account. Until very recently, only states made units of account linked to true media of exchange shared by a community. Goodhart (1988). Monopoly money does not count.

States are not unique as communities. Burke's little platoons are everywhere. The state is seldom the most important community in any person's life. It probably ranks well behind job, religion, hobbies, or family. These little platoons are likely stronger than the state. But they are *little.* In a commercial economy with anonymous transactors, money is mostly a matter of scale. The relative weakness of the state scarcely matters, compared to its scale. (Indeed, weakness may be a feature, not a bug. Granovetter (1973); Zelizer (2017).) And small states might not have the scale, especially if they participate in an open economy. The Queen may reign, but the British Virgin Islands use the Yankee dollar.

Enter the Internet. Social media are instant community. They bind their user tightly—I believe that the term of art is "engagement." They have far more engagement than any government, except perhaps North Korea's. And some of them are large. One of them—Facebook—believed it was large enough to create a monetary community through affinity and scale, boasting its own unit of account. With several billion users, it has more scale than any government. Why can't it create money? It has more latent transactional powers than most states. Hence Libra.

The Libra project is not doing too well as of the time of writing. I am not in the predictions business. I only want to explore the barriers to success that it—or a successor—may have. Of course, this depends on what is meant by "success." Bitcoin is an existing non-statal money: people pay with it. But it is not a very good one. It is an unstable unit of account, linked to a poor medium of exchange. It has a very unimpressive monetary community: hucksters, chumps, and criminals. Facebook has billions of users, all wanting to pay for things.

How, then, can a system like Libra fail? Let me count the possibilities.

Libra is not legal tender. However, this should not make a substantial difference. Legal tender is a very narrow concept in commercial law: protecting payors from bad-faith refusals to accept payment. Note (1928). Yes, the United States government will accept legal tender currency in payment of taxes. But it also takes checks, which are not legal tender. And it will even, under some circumstances, take foreign currency! 26 C.F.R. § 301-6316-1 (2019). And this is not to mention national bank notes—which were never legal tender—or pre-Depression Federal Reserve notes. "[L]ittle of consequence turns on whether a payment device is legal tender." Rogers (2005) at 1275. Once upon a time, the legal tender status of currency may have been a necessary mental crutch to those intellectually hobbled by the gold standard.[1] Nowadays, it means little more than "government-approved."

I hinted that Facebook's high engagement might be a problem. Pardon me; that was a feint. The engagement *through* Facebook is high, but Facebook does not create content. It supports diverse and often anonymous communities: many commercially minded. It a state can exercise its monetary hegemony through transactional power, why not Libra? To be sure, the state's transactional power is typically compelled: taxes. But compulsion is neither necessary nor sufficient. If enough people want to transact through Libra's facilities, it will have the transactional power.

We now turn to a third and more serious objection: that the state will want to quash a monetary system. I don't care why a state could want to quash: jealousy or crime prevention, maybe. I am interested in the state's *power* to quash. This is very much a matter of context. The United States, at one time, wanted to quash Eurodollars but failed. Bitcoin was designed to be difficult to quash. (That is why it is a poor money.) Notwithstanding Bitcoin, the state’s tools seem strong enough for things like Libra. The social medium providers are easy enough to suppress, if suppression is needed. The users will always stay connected, but the providers are as easy to regulate as any other large corporation. And this is not to mention the power embodied in anti-money laundering law: a concerted international attempt to demonetize particular assets.

So the state can almost certainly kill social medium money, if it pleases. But what if the state stays out of the way? Are there other barriers to success?

Anybody with enough transactional power, will, and luck can create a viable medium of exchange: PayPal, MPesa, Zelle. But units of account are different. They require more than transactional power and luck. They also require faith—communal mystique.[2] Communal mystique is easy to come by—sports teams, churches, guilds, maybe universities. But here, we run into the Granovetter problem. Communal mystique usually involves strong ties—the zone where money does not flourish. Yes, a game of Monopoly is a strong but temporary community, with its own unit of account. And game money can scale up: witness the Second Life online game. But these special communities are corners of peoples’ lives—conventional money permeates the rest.

The combination of communal mystique and weak ties is rare. And strong credit helps, too! (The failure of the ISIS dinar is worth studying.)

Today, the state fits the bill: perhaps uniquely so. This is mostly a matter of mystique: the force of nationalism and the Westphalian state. Some small states have their own units of account, despite weak transactional power. (Some don’t.) Even weak state credit seems enough. (Maybe not Zimbabwe or Venezuela.) Totalitarian states also have their own units of account, despite their stronger ties to peoples’ lives. The mystique of today’s state cannot be taken for granted. After all, Alexander Hamilton feared the whimsical state, and wanted money under firm mercantile control.[3] But still, can social media—or anything else—rival today’s state?

By Joey Sommer, January 2020. Lev Menand lifted me out of a mental rut. Subsequent crashes are not his fault. Christine Desan corrected a number of my errors. The remainder are my own.

References

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1. Crafting this crutch was the life work of F.A. Mann (1992). Mann had the very difficult and practical task of legitimating fiat currency in an era that still believed that money had an external metric. He succeeded by keeping the old form of worship, but creating a new sacred fetish–legal tender currency. This was useful in its time, but the object of worship has evolved. The necessary mystique now resides in the central banks themselves, rather than the currency they emit. ↑

2. *See supra* note 1. ↑

3. "Though paper emissions, under a general authority, might have some advantages [over state currency] yet they are of a nature so liable to abuses—and, it may even be affirmed, so certain of being abused—that the wisdom of the Government will be shown, in never trusting itself with the use of so seducing and dangerous an expedient." Hamilton (1791), at 24. ↑

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Prompt for Discussion

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On October 10th, 2019, the SEC brought suit against Telegram, asserting that its $1.7 billion offering of Gram "tokens" violated federal securities laws. The same week, five large investors including Visa, Mastercard, Stripe, eBay, and Mercado Pago pulled out of Facebook's virtual currency Libra, apparently taken aback by the fierce criticism leveled at Libra by politicians and regulators. These events were striking, occurring as they did against a baseline of official inaction, ambivalence, or accommodation of virtual currencies. It is an opportune moment to ask: What are virtual currencies – money, securities, or speculative assets? How do they relate to modern political communities and to the financial architecture that those states support? Why at this moment have governments chosen to crack down on virtual currencies?

The movement towards virtual currencies took off in 2008, when an anonymous person or group introduced Bitcoin. In the decade that followed, Etherium, Peercoin, and others offered similar products: digital assets created and maintained by a decentralized set of participants that can be traded for goods and services. Many users praised virtual currencies on the ground that they eliminated the role of law, the government, and/or the financial industry. According to the Bitcoin model, rules intended to operate mechanically control the production of virtual currencies and limit the quantity of virtual currency ultimately created. Exchange occurs according to a technology that Marco Iansite and Karim Lakhani describe as “an open, distributed ledger that can record transactions between two parties efficiently and in a verifiable and permanent way.” (Harvard Business Review, 18 January 2017.) The same description suggests the theory underlying virtual currencies: as a community of independent users opts in and confirms the transfer of digital assets, it makes unnecessary both public payment systems and commercial banks as financial agents.

Within the virtual currency family, differences in technology, industry location, and ideology have emerged. While Libra claims the mantle of virtual currencies, for example, it does not use a blockchain nor, at least in its initial version, a decentralized network of users to confirm transfers. See FT Alphaville. And rather than aiming at avoiding governmental oversight, it offers a vision of financial inclusion.

In this roundtable, we invite participants to comment on the questions recently raised by the difficulties faced by Telegram and Libra. What are virtual currencies and how do they relate to public moneys? What is the theory of value that virtual currencies offer and are those theories supported historically? Are these monetary systems that are working outside the state – or payments systems derivative of state power? How do the differences between Libra and more traditional cryptocurrencies explain the governmental response? Are virtual currencies meant to fix problems with the current monetary or payments systems, and if so, what problems? Or are virtual currencies meant to evade those systems?

Contributions

July 3, 2020
Why Do We Keep Taking the Cryptocurrency/Blockchain Scam Seriously?
David Golumbia, Virginia Commonwealth University

June 12, 2020
Decentralization: The Rise of a Hazardous Spec
Gili Vidan, Harvard University

April 28, 2020
Virtual Money at the Edge-of-State
Finn Brunton, NYU Steinhardt School

April 22, 2020
Payment in Virtual Currency
Benjamin Geva, Osgoode Hall Law School of York University

April 15, 2020
What lies behind the apparent trust in cryptocurrencies?
Marcelo de Castro Filho, Massachusetts Institute of Technology
Susan Silbey, Massachusetts Institute of Technology

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Virtual Currency (in the Shadows of the Money Markets)
John Haskell, The University of Manchester
Nathan Tankus, The Modern Money Network

March 31, 2020
The Case for Cryptocurrencies as a New Category of Regulated Non-Sovereign Fiat Currency
J.S. Nelson, Villanova Law School

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March 4, 2020
Starbucks, Libra, and the Boring Future of Money
Lana Swartz, University of Virginia

February 26, 2020
Cryptocurrencies as Privately-Issued Moneys
Hilary J. Allen, American University Washington College of Law

February 20, 2020
Money at the Zero Lower Bound
Bill Maurer, University of California, Irvine

February 14, 2020
Regulate Virtual Currencies as Currency
Lev Menand, Columbia Law School