Digital Currencies: Great Caution

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Private digital currencies have become the reality and currently, according to estimates, there are over 1000 types of these currencies. Therefore, it is no surprise that frequently asked question is whether to invest in them or not. Currently, their use in Montenegro, as well as in euro area, is not regulated, and it opens many dilemmas.

With regard to the investment in digital currencies and their use, the central banks have quite different views. Thus, some countries, like India, prohibited the use of private cryptocurrencies. A number of national banks still examines this area, while others consider the introduction of their own digital currencies. However, the largest number of central banks warns the risks of their use. I would like to point out the warning expressed in June last year by the Bank of France Governor, Francois Villeroy de Galhau, advising"great caution with respect to bitcoin because there is no public institution behind it to provide confidence. In history all examples of private currencies ended badly".

The idea of private money is not new and it dates back to Hayek who, some forty years ago, wrote that the governments' exclusive right to issue money and regulate monetary flows did not give us better money than that would have otherwise existedif the governments did not perform the said functions. After the global financial crisis, the first digital currencies emerged with the idea of being independent from the governments and not subject to inflation. The most famous digital currency is bitcoin, and no institution stands behind it. A programmer's code processes the bitcoin mining, and financial institutions are not needed for daily payments; instead it is done by blockchain technology.

Since digital currencies are very weakly accepted as means of payment, it cannot be said that they assumed the main function of money. The Governor of the Bank of Japan, Haruhiko Kuroda, had once said that"bitcoin is being traded for investment or speculative purposes". Similar opinion was also expressed by European Central Bank (ECB) Vice-President Vitor Constancio, who said that "bitcoin is not a currency but sort of a tulip", alluding to a price bubble of the Dutch tulip mania in 17th century.

HIGH GROWTH IS THE RESULT OF SPECULATIONS

Bearing in mind the fact that the value of bitcoin has increased for very short period from 1,000 USD to 20,000 USD with high fluctuations, it is clear that such a trend in its value is the result of speculative factors. It is obvious that high speculative income can be earned from such a trend, but also an enormous loss can be incurred. Another fact that points to the great caution is that no monetary authority or state stands behind bitcoin and other digital currencies. There is no protection in case of failure of technological platform, the payments in this currency are small, and these currencies do not have any real coverage.

Also, Bundesbank Governor Jens Weidmann highlighted that the development of bitcoin has noticeably speculative character. However,Senior Deputy Governor at the Bank of Canada, Carolyn Wilkins, clearly pointed out that "cryptocurrencies are not really the form of money, but assets or securities, so they should be treated in that way". Australia's RBA Governor, Philip Lowe, was the most severe in expressing negative position on bitcoin when he pointed out that it is more used by criminals than by ordinary people.

There is a positive answer on whether it is possible to increase dramatically the value of an electronic note or other assets in relatively short period. The history shows a lot of examples in that respect. There were classical price bubbles that sooner or later burst, which resulted in making enormous income by small number of individuals that would withdraw on time. On the other hand, a large number of other type of individuals recorded huge losses. If all of us would mine and trade with digital currencies, and neglect real output, it is clear that the society will be doomed. In fact, this was one of the lessons learned from the global financial crisis, that all of us cannot be engaged in financial services and neglect real output.

Digital currencies do not have second important function of money, i.e. they are not units of account, since nowadays there is virtually no product which value is exclusively expressed by digital currencies.

These currencies do not possess third function of money, i.e. they do not store value. Namely, when a person owns money, he expects that it will have approximately the same value in the future. On the other hand, the value of digital currencies in the future cannot be estimated not even close.

Although it can be drawn clear conclusion from the above-mentioned that digital currencies in fact are not real money; they have become reality, and it will be more difficult to ignore them. It is expected that increasing number of countries will start regulating them in the future. It is certain that blokchain technology is something that opens a room also for improvement of financial systems.

As a country in the process of the EU accession, Montenegro surely should follow the regulation adopted by the European Central Bank. However, until these currencies become widely accepted means of payment, i.e. until they obtain all characteristics of money (medium of exchange, unit of account, store of value), one should be very cautious in investing in these currencies.

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