Will digital Gold-Backed Currencies Revolutionize the Digital Economy?

Overview

In previous articles, we've covered the idea that gold has been used as a medium of exchange for thousands of years and in the 1900s, the majority of Western currencies were backed by the commodity. Ultimately, it helped to define the value of fiat currencies and standardize global transactions.

In this article, we will delve deeper into how mass adoption of gold-backed cryptocurrencies such as USDVault, can have wider benefits for global economies.

To set the stage, let's quickly review how and why jurisdictional fiat currency became so valuable as a medium of exchange so that we may better understand why gold-backed cryptocurrencies are such a compelling and attractive proposition in the new digital economy.

Fiat currency and global transactions

As you'll recall from our Modern Money series, the earliest forms of money were anything that was considered useful and valuable enough to trade.

In primitive societies, food, animals and raw materials were considered 'money.' In this sense, money could be defined as anything that has intrinsic value.

However, as societies became more sophisticated, money was no longer used simply as a means of exchange, but instead evolved into an option to spend. More symbolic forms of money began to emerge, which helped to reduce transaction costs. At this point, money transitioned into what we now know as currency - which is defined as a physical or virtual representation of money, which exists either as a material token or as an electronic account.

As economies became significantly more complex, money grew increasingly abstract and centralized, before evolving into fiat currency. At the same time, governments began to decree what was and wasn't considered valuable, which facilitated the standardization of currency across jurisdictions.

However, one of the downsides of centralization is that as individual citizens and small communities lost control over a widely accepted means of transaction, governments were able to manipulate the money supply and this wasn't always in the best interests of the population. At times, over-regulation and reckless government spending created economic instability and hyperinflation.

Despite these issues, fiat currency has served a valuable purpose in the economy over the last 100 years and paved the way for financial innovation and economic prosperity.

The tepid rise of cryptocurrencies

Nonetheless, the appetite to innovate beyond overzealous institutions helped to fuel the rise of cryptocurrencies. The decentralization of cryptocurrencies has been part of the appeal as it facilitates direct transactions between people, free from governmental/institutional middlemen. The introduction of smart contracts and the fact that cryptocurrency transactions are recorded on the blockchain, has further benefited in increased transparency and security.

However, the adoption of crypto has been tepid at best by most consumers and institutions, and there are several reasons that contribute to this slow adoption.

Most prominently, the volatility of cryptoassets has hindered the widespread adoption of the technology and fuelled much of the skepticism about whether cryptocurrencies can be used as a medium of exchange.

Critics also point out that the vast majority of cryptocurrencies are uncollateralized, meaning that they are backed by nothing except sophisticated algorithms and the expectation that they will maintain a value. Even those tied to the price of other cryptoassets or commodities may face issues in the event of market instability, as most have no underlying legal structure that ensures investor claim to the purported collateral. As such, investors would be unable to recover their losses as there would be no centralized authority to hold accountable.

Indeed, some high-profile investors have been very vocal about their skepticism of cryptocurrencies.

Jamie Dimon, CEO of JPMorgan Chase said that Bitcoin is "...creating something out of nothing that to me is worth nothing," before adding: "it will end badly."

Warren Buffett, CEO of Berkshire Hathaway, has also weighed in on the Bitcoin debate, and told investors to "stay away from it," adding "it's a mirage basically."

He added that cryptocurrencies, in general, attracts charlatans and should not be considered a serious investment, stating: "I don't think that they bring much to the table in terms of capital allocation or investing. I may be missing something entirely."

While some investors have completely dismissed cryptocurrencies, other critics have acknowledged that although tokens such as Bitcoin are known for their volatility, the potential benefits of other cryptoassets should not be overlooked.

In a 2014 letter to investors, Seth Klarman, CEO of hedge fund Baupost Group made this exact point when he said: "While Bitcoin is yet another bandwagon we are happy to let pass us by, the thinking behind cryptocurrencies may contain a kernel of rationality."

Stablecoins: A Different Class of Cryptocurrency

So, it's clear to say that while the technology of crypto holds potential, the asset class is not without its very vocal institutional naysayers - most of whom repeatedly hark on the claim that, without backing, the entire asset class has no inherent value.

While tokens such as Bitcoin and Ethereum are indeed subject to frequent peaks and troughs, collateralized stablecoins such as USDVault will offer investors a viable and unique alternative to traditional cryptocurrencies and uncollateralized tokens.

One of the biggest advantages of stablecoins is that they are specifically designed to hedge against the volatility of other cryptocurrencies such as Bitcoin or Ethereum. However, different types of stablecoins vary significantly in terms of their value.

For example, some stablecoins such as Basis or Fragments are not backed by anything, which presents the same concern as other non-backed cryptoassets. This means that token holders have no recourse were there to be a collapse of the entity, bad actors in the system, or the algorithm proves to be unreliable.

Similarly, while fiat-backed stablecoins such as Tether and TrueUSD have attracted a lot of investment, the scalability of a model that relies heavily upon holding large stores of fiat currency in an uncertain legal environment is tenuous.

A New Gold Standard in Cryptocurrency

The team at Vault is therefore enthusiastic about our first precious metals backed stablecoin offering, USDVault. It’s the first token of its kind to be be backed by LBMA gold and pegged 1:1 to the US dollar, and be fully redeemable for gold or fiat currency. As such, the token is reinventing the gold standard on the blockchain, and issuing a new, institutional-grade solution to volatility in cryptoasset markets. The token enables traders to exit market volatility without moving into fiat or taking on commodity risk. Investors benefit from the scalability and liquidity of gold, which is redeemable for the equivalent value in dollars. This adds an additional layer of security for investors against the inherent risks in fiat currency, banking irregularities, governmental and legal disputes.

It bridges the gap between cryptomarketplaces and the oldest and the most stable financial asset in history: gold.

Use Cases for Stablecoins in Cryptomarkets and Real World Applications

Although stablecoins will not bring direct gains on crypto portfolios, they do provide an entry and exit point for the institutional investor. They also serve valuable purposes in the broader markets.

For example, the ability to control the timing either when entering or exiting an an investment position is one of the many difficulties that investors face. However, stablecoins eliminate this problem by providing a dollar-stable product from which traders can control the timing and flow into other cryptocurrencies. The same benefits will apply when investors exit their positions because stablecoins make it possible for them to execute the trades in a timely manner as they see fit.

As demand for cryptocurrencies continues to increase, Vault foresees that managers of crypto portfolios will need to control risk. Stablecoins such as USDVault will serve as a portfolio management tool in the sense that it will allow holders of different cryptocurrencies to reduce their exposure to the volatile market and gain the stability of an instrument that is pegged to the US dollar. Moreover, during periods of instability, USDVault will allow traders to crystallize gains or park funds without exiting the cryptocurrency market, and this is an advantage that will appeal to many investors.

Should a definite exit from the cryptomarkets be required, USDVault allows traders to redeem the tokens into gold bullion, or into fiat currency through the designated fiduciary partners.

Furthermore, as cryptocurrency achieves mainstream adoption, the team at Vault foresees that merchants will prefer to accept stable currencies versus less stable alternatives. For buyers and sellers of any product or service, knowing how much they are paying or receiving is an important consideration. The extreme volatility of most cryptocurrencies creates a great deal of uncertainty and serves as a roadblock to the adoption of cryptocurrency as a practical medium of exchange.

Lastly, USDVault sees great potential to address montetary stability concerns even outside of cryptoasset markets. Around the world, many millions of people are stuck holding currencies that are losing value and purchasing power and, in extreme cases, governments take dramatic action to freeze conversion into other currencies. USDVault and other stablecoins hold the promise of providing millions of people around the world with an unprecedented level of financial security, specifically during times of unrest and political instability.

For these reasons, stablecoins such as USDVault are instrumental to the new digital economy.

While they are not the most exciting asset, the stability and security of these cryptoassets will undoubtedly help to instill a greater level of confidence among institutional investors and businesses and this may one day help to facilitate mass adoption of cryptocurrencies.