CRYPTOCURRENCIES: ARE THEY THE FUTURE OR JUST ANOTHER SCHEME TO TAKE WITHOUT GIVING?

By Edward J. Dodson/ February 2023

For much of human history, people lived in small, tribal societies, producing very little surplus as hunter-gatherers. What individuals produced became part of the group's common assets shared more or less equally. However, there were those members who developed specialized knowledge of natural occurrences mysterious to almost everyone else. These knowledge-bearers affected a redistribution of wealth to themselves in return for the wisdom they obtained out of their demonstrated ability to communicate with the gods.

As the centuries came and went, as societies began to settle in one place, egalitarian tribal structures gave way to hierarchy. And, with hierarchy came an increasing pattern of wealth redistribution from producers to a rentier aristocracy and its religious counterpart. The societal structure required that the output of producers exceed what was required for their own subsistence. This encouraged specialization. And, with specialization of production came the need for systems of exchange and record-keeping. Producers brought their goods to market, entered into contracts with one another, and reached agreement over what goods would serve as a medium of exchange.

Fast forward to today and what we have is a system of money and credit that in many ways would be familiar to the ancients. They eventually embraced precious metals as a universal medium of exchange. Governments minted coins out of these metals and declared them to be legal tender and an accepted form of payment of taxes, fines and other fees. The Crusades reopened trade with societies of the eastern Mediterranean. Shipbuilding blossomed as did a new age of exploration, financed by medieval and then Renaissance banking families.

The Dutch created the first deposit bank in 1609, minting coinage of a standard metallic content out of deposits of precious metals and other coinage then in circulation. Depositors received a receipt for their money that could then be used in payment of goods or services. This experiment in full reserve banking lasted only until the banking officers began to issue bank notes that exceeded the bank's actual capital (i.e., the fees charged to depositors for the services the bank performed). So-called fractional reserve banking was then adopted as the new standard, with numerous periods during which governments halted the payment of gold to repatriate currency other governments did not want to hold in reserve. For some time now, the only control over the expansion of the money supply by central banks has been the fear of skyrocketing inflation. And, the only tool available to central banks is the raising of interest rates in an effort to reduce the reliance on credit. A delicate balance is required to tame inflation without causing recession and widespread unemployment.

Since the appearance of the first bitcoin cryptocurrencies, the threat to existing systems of money creation and credit allocation have taken center stage. We are trying to understand the long-term usefulness and impact of a medium of exchange that is neither tangible nor has the status of legal tender. The very fact that the investment community has a strong interest in cryptocurrencies tells me that the exchange value of these currencies is driven by speculation and, therefore, vulnerable to cycles of boom and bust. They appeal to our instinctive rent-seeking behaviors, that is, to take without giving.

If the societal objective is to establish a medium of exchange that retains its purchasing power, cryptocurrencies have yet to prove to be any better than the notes and their digital equivalents issued by central banks. Modern monetary theory makes a reasonable argument that the treasury departments of many governments can issue "debt free" money into circulation without the threat of inflation, if done subject to certain rules. What would strengthen this systemic change, I believe, is an international treaty under which participating governments agree to monetize a significant portion of whatever gold and silver are held in government vaults. At present, these stocks of precious metals held in government or bank vaults serve no purpose except as payment of last resort in the event of hyperinflation.

Why not mint gold and silver coinage of a standard weight and measure held on deposit equal to electronic currency balances made available to be spent into the economy by government departments. Here, then, would be a form of currency available to settle account balances between governments not subject to shifting political or economic winds. Such an alternative currency also solves the problem experienced by countries adopting a universal currency while maintaining sovereign control policies over taxation and spending.

To be sure, cryptocurrencies are here to stay despite the harm they cause to the environment associated with the electrical energy needed to run the computers involved in blockchain technology. What is being called "Proof-of-Stake" methodology promises to dramatically reduce energy consumption. Other innovations are certain to follow. However, I end with a warning by Brookings researcher Tonantzin Carmona in March of 2022:

> "As the federal government attempts to develop a regulatory framework for cryptocurrencies, local leaders should exercise caution before promoting cryptocurrencies or establishing policies without adequately understanding how they function."

As we know from experience, all asset bubbles eventually burst. Cryptocurrencies have performed as promised if one is paying attention to the historical record.