LA Progressive

The Problem(s) with Bitcoin

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Yves Smith of nakedcapitalism.com calls Bitcoins “litigation futures.” In a KQED Forum Virtual Reality pioneer Jaron Lanier says most of the bitcoin he’s seen is part of a Ponzi scheme. One of the founders of Modern Money Theory, Warren Mosler, believes bitcoins’ actual use is to anonymize parties to transactions. In such transactions, bitcoins have no value except the one assigned by parties to the transaction. You only need one bitcoin which serves like an “envelope” to pass money anonymously.

Its biggest problem is that bitcoin embodies a fundamental misidentification of currency. Essentially, currency is a measurement, not a commodity. You can never run out of (sovereign, fiat) money, any more than you can run out of inches. Greece gave away its monetary sovereignty when it joined the EU, and the austerity enforced by the EU–under the pretense that money is in short supplly–is the basis of its current problems.

So currency measures “I owe you one”–obligation or debt. Even typical commodity-backed currency says, in effect, “I owe you a lump of gold.” In addition to its measurement of obligation, the currency of account (for us, dollars) also satisfies an inevitable obligation–taxes. Taxes give dollars their value, they do not provision money-issuing government. Where would people get the dollars with which they pay taxes if government didn’t spend them out into the economy first?

The next time you hear a national politician say “Oh we can’t have [blank]” where blank is anything from free college tuition to single-payer healthcare, “because we’d have to raise taxes too much to afford it.” … you know they are not telling the truth. Taxes make the money valuable; they do not fund programs.

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Recent experience validates that assertion. No one said "We're out of money" when we declared war on Iraq, or when the Ponzi capitalism of Wall Street collapsed. The cost of the war in Iraq is an estimated $3-$7 trillion. According to the audit of the Federal Reserve (which it resisted), it issued $16 – $29 trillion in credit to the banks. We didn't raise taxes; and we certainly didn't hear the battle cry of austerity ("We're out of money!"). So wars and bank bailouts get unlimited funding, but social programs don't. But the truth is that we could end the payroll tax tomorrow and Social Security recipients could still count on the government to make as many dollars as were necessary to fully fund their benefits.

Unlike money, we *can* run out of commodities. So if the available commodities limit the amount of money (as with gold-backed currency), then it typically bakes deflation into the currency design. (That's a bit of a simplification because we have had inflation and deflation under the gold standard, depending on new discoveries, or depleted old ones.) In any case, bitcoin is commodity-backed money, the commodity being the energy spent to generate its encryption.

Note: there are literally climate consequences when energy generates currency, and not good ones.

Typically, deflation and austerity are what commodity-backed money justifies, if only because commodities are finite. This limitation is why all modern economies use fiat money. Fiat money can never run out, and gives policy space to keep the economic policy and a particular commodity independent from each other.

In contrast to understanding money as measurement, believing money must be commodity-backed bakes austerity into the economy. Political economist Mark Blyth says you can have commodity-backed money or democracy, not both.

Incidentally, Blyth is very well versed about austerity, but hasn't got the sophistication of the Modern Money Theorists about government "debt."

It's also crazy to tie the money supply, and really, the fate of the economy, to the production of gold or any other commodity in any case.

The typical excuse for something like gold-backed currency is that it's supposed to prevent inflation, but not even that is true. Imagine what inflation the Spaniards experienced when they started importing all that New World gold! Even the concern about inflation that fiat money would unleash is overblown. A recent Cato Institute study of 59 historical hyperinflation episodes discloses that none were initiated by a central bank run amok–all of them originated with shortages of goods. So the Rhodesian farmers left Zimbabwe, and food ran short…leading to hyperinflation. The French invaded and shut down part of Germany's industrial economy (the Ruhr), leading to the Weimar inflation.

So…the statement that money is measurement, not a commodity is a little controversial to say, but its accurate. In the 5,000 year history of money, gold backing only exists for 200 years. Economist Hyman Minsky says "Everyone can make money; the problem is getting it accepted."

Thinking of money as debt, or an IOU

If I have a garage sale, and neighbor Bob wants to buy my old lawn mower for $50, but doesn't have the dollars with him, and he offers me an IOU for $50–knowing where Bob lives–I decide to accept. Later, neighbor Sally asks me "Where's that $50 you owe me?" I offer her Bob's IOU and she accepts. Now Bob's IOU is a "money thing." It's not accepted at Safeway for groceries, but that's the dynamic. We used debt as money.

You're most familiar with this if you have a bank account. That's your asset, but to the bank, it's a liability (a debt). The account itself doesn't change, but how it appears (asset or liability) depends on your point of view. When you write a check on that account, you're really assigning a portion of the bank's debt to the payee. Again, using debt for money.

Currency is, in effect, checks made out to "cash" in fixed amounts, signed by the Secretary of the Treasury. And since it really is debt, currency appears on the books of the central bank (the Federal Reserve, or "The Fed") as a liability, too. In fact the dollars say "Federal Reserve Note." (A "note" is an IOU). For dollars, the big attraction is that they provide relief from an inevitable liability–taxes. Modern Money Theorists say "taxes drive money."

So now that we know currency is a liability, what's the sum total of the dollar financial assets out in the economy? We call it "National Debt."

So no, it's not going to crush our grandchildren, and it's nothing like household debt (something Obama said). In fact, when we've succumbed to the siren song of "Fiscal Responsibility™" believing we owe some commodity and have reduced National 'Debt.' This occurred seven times since 1776, and 100% of the time we get a Great Depression-sized hole in the economy within a few years paying down that "Debt" in a major way. The last such significant reduction of "Debt" was the Clinton surplus. The time before that occurred in 1929.

Obama tried and failed to make another such reduction, skimping on recovery money, and the economic recovery was anemic enough that Democrats lost every branch of the Federal government and 1000+ down ticket races.

Why have depressions following "Debt" reductions? Dollar financial assets (Fed liabilities) are, in effect, the savings of the population. Reduce people's savings, and they have trouble paying their obligations. Even the slightest economic shock makes a default occur when savings aren't present to back up the ability to pay. So sure enough, such "debt" reductions are followed by waves of defaults, asset forfeitures and foreclosures–i.e. depressions–because people don't that backup when their obligations come due.

One more thing: Here's a really radical money use from Modern Money Theory–which is where I get this stuff (seriously, read the short article linked earlier in this sentence). Not only could we guarantee every person a job who wanted one (and a Job Guarantee is better in many ways than

Basic Income Guarantee), we could supplant regulation with a system of rewards for sustainable industry and agriculture…without raising taxes a nickel.

Incidentally, the quotes around Federal ‘Debt’ are there because it’s absolutely nothing like household debt. How many households can go into the back bedroom and print the wherewithal to pay their obligations?

In my humble opinion, this is critical path knowledge, and people have real trouble even hearing it because it contradicts so much of the embedded narrative about how economics works. Max Planck, the discoverer of the “quanta” of “quantum mechanics” was similarly frustrated when he tried to convince the physicists of his age that quanta described how the physical universe worked.

Planck’s declaration: “The truth never triumphs. It’s opponents simply die out. Science advances one funeral at a time.”