

# Beyond Bitcoin, It's Time for Cryptocurrency Boards

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In 1999, Milton Friedman, the world's foremost monetary luminary, foretold the rise of cryptocurrencies. Here's what he had to say:

I think that the Internet is going to be one of the major forces for reducing the role of government. The one thing that's missing, but that will soon be developed, is a reliable e-cash method whereby on the Internet you can transfer funds from A to B without A knowing B or B knowing A. The way I can take a \$20 bill, hand it over to you, and then there's no record of where it came from. You may get that without knowing who I am. That kind of thing will develop on the Internet and that will make it even easier for people using the Internet. Of course, it has its negative side. It means the gangsters, the people who are engaged in illegal transactions, will also have an easier way to carry on their business.

More than 20 years after Friedman's prediction, the speculative mania surrounding cryptocurrencies is breathtaking. Just consider that Bitcoin's price has skyrocketed 1,030 percent in the past twelve months and that its market capitalization has soared to \$1.1 trillion, which makes it the world's sixth-most valuable asset.

With Elon Musk's announcement that Tesla would purchase \$1.5 billion worth of Bitcoin in order to start "accepting bitcoin as a form of payment for [its] products in the near future," the frequency of Bitcoin's mentions on Google and its trading volume have risen sharply and in lockstep in 2021.

Putting aside Bitcoin's meteoric ascent in price, which has been punctuated by dramatic booms and busts, it is important to note that its designation as a "cryptocurrency" is a misnomer. A currency is characterized by four fundamental features. To qualify, it must be unit of account, must be a standard for deferred payment, must be a store of value, and must serve as a medium of exchange.

Just how does Bitcoin stack up when it comes to these currency criteria? Bitcoin's volatility turns out to be its Achilles' heel. In 2020, Bitcoin's annualized daily volatility was an astonishing 67 percent. If we look at the most important price in the world, the USD–euro exchange rate, and the world's international currency, the U.S. dollar, the dollar's annualized daily volatility in 2020 was only 7.8 percent. Since Bitcoin's source code predetermines that Bitcoin's supply will ultimately be fixed and totally inelastic, all market adjustments can take place only via price changes, not quantity changes. As a result, it is destined to be inherently subject to extreme price volatility. This means that Bitcoin will never serve as a reliable unit of account. You will rarely see items with Bitcoin price tags attached. You will also never see deferred contracts (contracts under which payment is made under a long-term credit

arrangement) written in Bitcoin. Can you imagine someone writing a mortgage contract denominated in Bitcoin?

Bitcoin's volatility also renders it unattractive for most corporations to hold in lieu of cash reserves. Indeed, Bitcoin, which is considered an intangible (something, incidentally, that brings inconsistent and opaque accounting treatment in its wake), throws considerable risk on to balance sheets. In short, it is not a reliable store of value. It's no surprise, therefore, that most corporations are unwilling to take on the risks associated with holding Bitcoin on their balance sheets. A recent survey found that roughly 5 percent of finance executives said that "they planned to hold bitcoin as a corporate asset in 2021" and "84 percent of respondents said they did not plan to ever hold bitcoin as a corporate asset," citing volatility as their foremost concern.

Furthermore, very few items are purchased with Bitcoin. Items are not only not priced in Bitcoin, but the transaction costs associated with Bitcoin are excessively high for both buyers and sellers.

Bitcoin clearly falls short of meeting the four standard criteria to be designated as a currency. Accordingly, it should not be viewed as a currency but as a speculative asset with a fundamental value of zero. That being said, Bitcoin does have an objective market price. That price is determined by speculators operating in a whirlpool in which they are purchasing an asset with very little or no utility in the hope of selling it later at a higher price: greater fools and all that.

If Bitcoin's failure to meet the currency criteria isn't bad enough, it even falls short of the aims of its architect (or architects), the pseudonymous Satoshi Nakamoto, who envisioned that Bitcoin would function as a currency. Nakamoto anticipated that Bitcoin would address three problems with "government" money, each of which Bitcoin fails to solve.

First, Nakamoto asserted that Bitcoin would overcome the lack of trust associated with fiat monies issued by central banks. But Bitcoin, which is fiat, has a history defined by fraud and breaches of trust, illustrated by the Mt. Gox scandal. Second, Nakamoto designed Bitcoin to address privacy concerns. However, about 95 percent of all cryptocurrency trading occurs on centralized exchanges. These exchanges often collect identifying information from their users and have a history of failing to protect such information. Finally, Nakamoto complained of the "massive overhead costs" of commercial bank transactions that "make micropayments impossible." Yet, due to technological limitations and fees charged by exchanges and cryptocurrency providers, Bitcoin is impractical and too costly to facilitate most transactions. For example, popular cryptocurrency exchange Coinbase charges a "base rate for all purchase and sale transactions in the US [of] 4%."

Beyond Bitcoin, there is ample potential for innovation in private money, specifically a price-stable digital asset. Several attempts have been made, such as the popular stablecoin Tether and Facebook's Libra, but these efforts have been fraught with problems. Tether claims to be "100% backed by our reserves." However, in 2021 an investigation by New York Attorney General Letitia James found that "Tether's claims that its virtual currency was fully backed by U.S. dollars at all times was a lie." Additionally, as reported by Bloomberg, JPMorgan Chase & Co. strategists including Josh Younger and Joyce Chang wrote in a report that Tether has "famously not produced an independent audit and has claimed in court filings that they need not maintain full backing." This is less than reassuring. Libra failed to establish itself in its original form, and, renamed and restructured, is supposed to be relaunched in the near future.

Thanks to ease of entry and competition, inferior cryptocurrency products will struggle, in the end, to survive. Just look at Bitcoin. Although its market capitalization has skyrocketed, Bitcoin's share of the total crypto market has fallen from 94 percent in April 2013 to 61 percent today. Eventually, Bitcoin's current limited use value will likely be eclipsed by the offerings of superior challengers. So, just what might an effective competitor look like?

It would be in the form of a private cryptocurrency board. A traditional currency board issues a currency that is freely convertible at an absolutely fixed exchange rate with a foreign anchor currency or gold. Therefore, under a currency-board arrangement, there are no capital controls. The currency issued by a currency board is backed 100 percent with anchor-currency reserves. So, with a currency board, its currency is simply a clone of its anchor currency. Currency boards have existed in about 70 countries, and none have failed — including the North Russian currency board installed on November 11, 1918, during the Russian Civil War.

What all currency boards — past and present — have in common is that they are public institutions, but there is no requirement that currency boards be publicly owned. A private cryptocurrency board would be the ideal institutional arrangement for the crypto world. For example, its home offices and reserves could be located in Switzerland, a safe-haven financial center, and it could be governed under Swiss law. It could be operated with a small staff, as is the case with all traditional currency boards. As for its anchor, it could be a currency issued by a central bank, or gold, which is not issued by a sovereign. Furthermore, given its digital nature, the balance-sheet information of a private cryptocurrency board, including its reserves, could be publicly available and audited by independent auditors on a regular basis.

With such a system, the crypto world would finally have a product that is more than just a speculative house of cards.

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