

What can go wrong with Bitcoin, Libra and other cryptocurrencies?

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with [Leonidas Zelmanovitz](#)

A monumental struggle between government and market (that is, between the government and the people) could take place. Who would win?

For investors, what can go wrong with cryptocurrencies? In regular times, not much. First, the brokerage of crypto-assets is something new, and a body of self-regulating norms has not evolved yet. Proper protection mechanisms may be lacking also because these brokerage houses are not regulated

(although that may change soon because a recent FATF recommendation calls for the government to step in). In short, investors can be defrauded, harmed, hacked or swindled.

Second, crypto-assets price can float abruptly. Investors may lose (but also gain) fortunes. In theory, stablecoins minimize this risk; Facebook's Libra, in particular, would dramatically minimize volatility if it should ever come to exist. Third, market manipulation is always a possibility, and there is no guarantee that the crypto-assets brokers themselves will not be involved. So there are risks – and yet, what in life doesn't? When we factor in the potential for gains in asymmetric trades such as Bitcoins, it all sounds like a reasonable bet.

The above analysis however contains an important assumption that often goes unnoticed. It supposes a certain level of normality in politics, financial markets and international finances. But what if normality doesn't hold? Would the analysis change? This is the key point. A monumental struggle between government and market (that is, between the government and the people) could then take place.

Who would win? To understand, we should first consider that there is a sharp difference between what crypto-assets are today, and what they may become. In the US, there are online sales shops that accept payment in bitcoin. It is also possible to use Bitcoins to buy gift cards at big chains like Home Depot, Kmart and Amazon. And with a gift card one can basically acquire anything, anywhere. Cryptocurrencies are also used for some daily operations in countries undergoing monetary instability, [Argentina and Venezuela now offering illustrative examples](#). But even in these places, ordinary payments with cryptocurrencies are still overall uncommon.

This is very different from what cryptocurrencies enthusiasts consider “success”. Theirs is a vision where e-wallets, cryptos and other forms of digital money have been completely normalized. The banking model as we know it today may or may not change drastically, because entrants in the payment arena may operate similarly to banks. But a key aspect is that in this

world at the very least digital assets can be used as collateral; and more dramatically, prices are quoted in cryptocurrencies, because people store liquidity in Bitcoins, Libras, etc.; not in national currencies.

One of the characteristics of this futuristic world dreamed by cryptoenthusiasts is that governments would have a hard time stimulating the economy with monetary policy. Nowadays, to face low activity cycles, governments issue money and buy bonds in circulation in the market. Expectedly, the textbooks tell us, this causes a fall in bond yields, driving down the interest charged on other transactions in the economy as a whole, stimulating consumption and investment.

It is all standard practice, but it can only work if savings are kept in the national, fiat currency. If savings are kept in crypto-assets, the monetary impulse given by the government does not do the trick, because it does not change relative prices in the economy. To be sure, hindering government from doing monetary interventions has its advantages; just do not expect central bankers to see things that way.

So under severe pressure, what could governments do? History helps us here. In 1933, during the “abnormal” times of the [Great Depression](#), president Roosevelt famously issued a decree forbidding people and companies from keeping gold, an episode we have been recently reminded by Sebastián Edwards’ book, [American Default](#). The decree determined that all gold should be sold to the government at a predetermined price. Roosevelt’s strategy was to push aggregate demand, punish savers and force people to spend so as to inflate prices and stop the deflation cycle. It was an extreme measure, of debatable efficacy and employed during a severe crisis.

This historical example illustrates well the kind of problem that can happen outside of economic normalcy. Fast forward and place yourself in the future where cryptocurrencies have “succeeded,” savings are kept in cryptos, especially in Bitcoins, the “synthetic gold,” and prices are not denominated in fiat currency. Suppose there is an economic depression for whatever reason. Could a government put in place a measure similar to that of the Great Depression?

A good question is whether digital confiscation is even possible. For instance, in the case of Bitcoin, all that is needed to trade is a digital wallet and internet access. If transactions are forbidden in one country, a simple VPN or a proxy system will allow international operations. The existence of devices such as Opendime – a USB flash drive that can be loaded with Bitcoin by the first user and given to another user, who is, in turn, able to pass it along to a third user and so forth – would only make the government task a little harder.

So killing Bitcoin may be impossible, but that does not mean that a Bitcoin prohibition would be inconsequential. If crypto operations became less attractive, their value could plummet. Would people then migrate back to fiat? If they did, the view of money as a state creature would be vindicated. This is a little tricky. Moneys are not all created equal, and neither are the governments that create them. If a crypto prohibition were tried by the government of a developing country, odds are it would not work. Developing countries governments tend to be overall weaker and to lack popular support, especially during economic downturns. Besides that, the outburst of a financial crisis in their national domains could hardly be called “abnormal”.

The story is very different within the countries that comprise the core of the international financial system. In the latter, governments are stronger and their actions can be more effective. Recent initiatives by the Chinese government to close bitcoin brokerages and prohibit ICOs (Initial Coin Offerings) at least demonstrate the ability of government to change the rules of the game when needed.

Of course, not every cryptocurrency is the same. If a cryptocurrency is run by a centralized system, such as in the case of Libra, the government stands to have a much greater chance to effectively regulate, control or ban the crypto. To illustrate, Congress has recently sent Facebook a letter requiring the suspension of the Libra project. If Congress had instead wanted to suspend Bitcoin, there would simply be no one to even address the letter.

Another relevant aspect that conditions government efficacy would be the extent of private adoption of cryptos. A company such as Uber offers a relevant benchmark. In some places, Uber services have become so ingrained and widespread that the mere threat of government restriction causes

strong backlash from users and drivers (and enthusiasts). That makes it impossible for governments to even consider reinstating the rules that had once favored taxi drivers. The lesson is that beyond a certain point, a cryptocurrency can become too big to ban. This might be cryptocurrency enthusiasts' best bet.