Man on the Margin

Classical Economics in a Quantum World

Notes on The Bitcoin Standard

Michael Kendall July 16, 2018 0 Comments

George Gilder's new book***, Life After Google***, is out today. In October 2017 George sent me a draft of Saifedean Ammous' book, ***The Bitcoin Standard***. I was excited to read Saifedean's draft because Bitcoin offers tremendous promise. I quickly realized that Saifedean champions the monetary design flaw that makes Bitcoin unsuitable as a currency. If this flaw is corrected, Bitcoin can achieve its revolutionary promise. I sent George this response to *The Bitcoin Standard*. He adopted my view for *Life After Google* in the chapter, The Bitcoin Flaw.

*Note: The page numbers in my notes are from the draft copy. I do not know if they match the published edition of *The Bitcoin Standard*.

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George,

I reviewed the book and my notes follow my comments.

The Austrian-Rothbardian economic view weaves in and out with the Classical economic view. There is a lot in common but also some major differences. In general, they both agree on sound money, small government, and low taxes.

There are major unresolvable differences on the monetary side. **Mainly, what does sound money mean?** This is evident in the author's Rothbardian view of the Great Depression as a monetary event. Nathan Lewis has destroyed this view with data, and I have written about it here, in addition to Nathan's original work on his website. Nowhere does the author mention taxes as a contributing factor to the GD. This puts him in the errant money, prices, interest box that Nathan has also written about extensively.

Bitcoin, as designed, is deflationary. The author finds nothing wrong with this. In fact, it fits the Rothbardian desire for a fixed base money supply beyond the control of the government.

This conflicts with Mises' warning on the danger of deflation, no different from inflation. I find it contradictory that one can pick and choose from the Austrian canon what suits their purposes. Either deflation is bad (Mises) or it is not (Rothbard). (See Mises comment on deflation below)

The other major error the author makes is conflating base money with the money supply, M2. This is an error that throws off all his data and his argument. The only money is base money. The Fed 100% controls base money but only indirectly (if at all) influence credit which is included in M2.

These are major differences which cannot be resolved within the Classical and Rothbardian views. How one accepts these views determines whether the thesis of the book is valid or invalid**. My Classical view is that the thesis is invalid** based on the irresolvable major differences that I highlight.

I expand on agreement and differences that I find in the author's view in my notes.

Final thought:

The difference between Classical and Rothbardian monetary views is that Classical economics has been put into effect. **It has a 300-year history of monetary success with a gold standard.**

The Rothbardian monetary view has never been put into effect. (There was a minor 100% reserves Bank of Amsterdam in late 1600s, but this was a very regional and brief experiment.) Rothbardian monetary policy can attempt to prove its viability with bitcoin. Bitcoin with its limited supply defines the Rothbardian monetary system. There's a reason the world has not adopted a Rothbardian monetary system up until now. It won't work, and bitcoin, **as designed**, will not last as a functional currency.

Whether deflation is caused by monetary error, correcting from an inflation, or from a fixed currency supply, the result is the same. Deflation is an economically harmful monetary event.

Mises on deflation from *Human Action*:

"People labored under the delusion that the evils caused by inflation could be cured by a subsequent deflation. Yet the return to the prewar parity could not indemnify the creditors for the damage they had suffered as far as the debtors had repaid their old debts during the period of money depreciation. Moreover, it was a boon to all those who had lent during this period and a blow to all those who had borrowed. But the statesmen who were responsible for the deflationary policy were not aware of the import of their action. They failed to see the consequences which were, even in their eyes, undesirable, and if they had recognized them in time, they would not have known how to avoid them. Their

conduct of affairs really favored the creditors at the expense of the debtors, especially the holders of the government bonds at the expense of the taxpayers. In the twenties of the nineteenth century it aggravated seriously the distress of British agriculture and a hundred years later the plight of British export trade. Nonetheless, it would be a mistake to call these two British monetary reforms the consummation of an interventionism intentionally aiming at debt aggravation. Debt aggravation was merely the unintentional outcome of a policy aiming at other ends.

(p. 784, 1966 Regnery edition)"

Notes: *The Bitcoin Standard*

P.22 Not really a tragic flaw. Gold standards have to rely on currency managers. No way around it. A 100% gold reserve standard is not possible.

P.24 Gold mining is constant. No diminishing returns.

P. 38 Flaws again

P. 40 Good point, fiat exists because of original link with gold

P. 46 Rothbard 20s inflation. Wrong

P. 47 Great Depression analysis way off. Never mentions taxes.

P. 55 Reuff theory as a problem with BW

P. 59 How does he define money supply, M2?

P. 64 POG is not a function of demand. Refutes his own previous analysis.

P. 76 Again he conflated money supply with base money. This is errant analysis but it looks good on a chart. Fig. 18 is errant

Division of an appreciating value only means that each division increases proportionally in value regardless of the degree of division. This is an immutable fact and goes against the real role of a unit of account.

P. 77 Bitcoin's value is rising because it is deflationary, as designed. Demand exceeds supply

P. 78 Had its supply mimicked gold, it would not have the problems it has today.

P. 81 Used more as speculative bet than transactional currency due to supply limit.

P. 93 Don't agree with this:

"as any supply of money is sufficient for any economy of any size." Mises well explained the problem of deflation.

P.94 False "Any quantity of economic transactions could be supported by a money supply of any size, as long as the units are divisible enough."

Explains why gold is monetary (constant increase in supply) after describing he desires a fixed monetary supply. Contradicts himself in one paragraph.

P. 96 Missing the point of stable money: “As people develop a lower time-preference overall, more people are likely to want to hold money, causing a rise in its market value compared to other goods and services, further rewarding its holders.”

P. 98 Agree with Jastram analysis

P. 100 In Rothbardian camp that we must have currency free from any government control. Like a 100% reserve gold standard. Yet GB and U.S operated gold standard for over 200 years successfully under government control—as the author agrees with Jastram. His solution is not applicable. It won’t work.

P. 101 Wrong. sound money is money whose value doesn’t change. Again he references Jastram who showed that GB prices remained stable (NOT GAINING) in value over 200 years. Contradicts himself.

“Sound money is money that gains in value slightly over time, “

Agree with his section on Keynesian analysis and Peter Thiel

P. 113 Agree on knowledge and price mechanism

P. 119 Off the rails on this:

“A fundamental fact to understand about the modern financial system is that banks create money whenever they engage in lending.”

Again, confuses credit with money. The unbridgeable flaw of Rothbardians.

P. 120 Central banks don't manage the money supply, which includes M2**. Central banks may influence credit, but they cannot control it in any way, shape, or form.** They manage base money ONLY. **This confusion is Achilles heel of Rothbardians.**

"As the central bank manages the money supply and interest rate, there will inevitably be a discrepancy between savings and loanable funds."

Can agree with CBs controlling the price of interest causing malinvestment.

P. 124 Switzerland was forced to abandon gold. A small country cannot maintain a gold standard while the rest of the world is fiat—unless it wants its entire economic system to reside in banking and finance. Exporters can't compete with constantly devaluing fiat currencies.

See http://manonthemargin.com/switzerland-negative-interest-rates/

P. 125 Errant: "banks and governments could often expand their supply of money and credit beyond the gold held in their reserves,"

P. 128 Rothbardian view that monetary inflation caused the GD. Nathan destroyed this view with data.

See: http://manonthemargin.com/nathan-lewis-vs-economics-profession/

P. 130 Can agree on sound money and trade

P. 135 Utopian Rothbardian view that we can have currency free from government control. Even if currency were 100% gold (wouldn't work) or cryptocurrency beyond the control of government, government controls taxation. A currency can't function in its 3 roles when it is taxed as a capital gain. The government has ultimate control over currency through taxation even if they are unable to create it. Prevents real competition with government fiat.

P. 151 Agree with the problem of financialization caused by fiat devaluation

P. 165 Why is a deflationary monetary standard good? Mises wouldn't think so.

"For the first time, humanity has recourse to a commodity whose supply is strictly limited. "

P. 169 Re: Problem of gold has to be assayed. Bitcoin has its own limitations as Mt. Gox showed. The process of an individual securely maintaining their private key is extremely burdensome. An unintentional mistake may result in a catastrophic loss of one's bitcoin. The blockchain is in its infancy. It has many problems and growing pains ahead.

P. 175 Errant view of understanding how a gold standard works:

"Once the gold was centralized, its lure proved irresistible for governments, who took control of it and eventually replaced it with fiat money whose supply it controls."

P. 176 Despite recognizing the difference between a gold standard and bitcoin—gold is stable with a growing supply while bitcoin is deflationary—which disproves his entire argument, he doesn't acknowledge the contradiction:

“The situation would be like gold under the gold standard, as detailed in Jastram’s study referenced in Chapter 6. For centuries during which gold was used as money, the very low increase in its supply meant that its value did not increase or decrease significantly, making it the perfect unit of account across space and time.”

Notes on The Bitcoin Standard II July 23, 2018In "Bitcoin and Cryptocurrency"

The Flawed Monetary Theory of Craig Wright January 3, 2018In "Bitcoin and Cryptocurrency"

George Gilder: Life After Google - Book Review August 4, 2018In "Book Review"

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Notes on The Bitcoin Standard II

Michael Kendall July 23, 2018 0 Comments
Bitcoin and Cryptocurrency

George Gilder sent me a pre-publication draft of *The Bitcoin Standard* by Saifedean Ammous. We exchanged many emails on the topic of Bitcoin and cryptocurrency. **This is Part II of my reply to George after reviewing *The Bitcoin Standard*.**

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George,

I have been vaguely hinting about possibilities but let me give a bit more detail. I know that we see things similarly and are on the same page.

Here are definitions.

Deflation – an increase in value from a monetary standard.

Inflation – a decrease in value from a monetary standard.

Inflation and Deflation, therefore, have the same definition **– a decline of the monetary standard.**

Monetary Standard – an optimum monetary reference that eliminates inflation or deflation. Debtors and creditors are in equilibrium when an optimum reference is maintained. The exchange of goods, services, and trade are most efficient when **the monetary standard remains fixed.**

Historically, mankind has determined that gold is the monetary standard. It's not perfect, nor scientific, **but is the only monetary reference that can reliably act as a standard. Gold has done this job wonderfully for centuries.**

Bitcoin offers the Rothbardian (independent of Austrian) dream. Its supply is both free from government control and limited. This parallels the desire of Rothbardians to have only gold act as money. Nathan Lewis details all the problems with this in his excellent piece, Response to Rothbardians. Nathan wrote this in 2002 when he worked for Jude Wanniski at Polyconomics.

Bitcoin's fixed supply design is problematic.

1. **It is deflationary, so it is a decline in the monetary standard.**
2. Because it has a predictable and determinate deflationary increase in value, there is **no incentive for it to act as a transactional currency.** Any use as a medium of exchange today means you are giving up a predictable and determinate increase in value in the future.
3. Infinite divisibility does not solve this problem.

I consider the problem of Bitcoin and the promise of the blockchain and cryptocurrency and wonder, what is possible? **Can the limiting problems of Bitcoin and its effect on the blockchain be overcome?**

Since gold is the only monetary standard of reference, for a cryptocurrency to act as a standard of reference, **it will have to either mimic gold or be linked to gold. There is no other possibility.** There is nothing other than gold to compare with or to use as a reference in the monetary realm. If gold is ignored, you are attempting to reinvent the monetary wheel while discounting monetary history. You are regressing.

What makes gold a monetary standard (beyond its properties which there is no need to address) is its lack of a capital component which combined with its preciousness results in a constant annual supply. It is gold's massive stock compared with its minimum flow that makes its value stable.

Cryptocurrency offers the same properties as gold in addition to infinite divisibility. The solution requires . . .

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The rest of my reply discusses a solution for Bitcoin, cryptocurrency, and the blockchain. Imagine that in the early days of the internet, the promise of multiple computers communicating on a single network existed, but a programmed design flaw prevented the network from expanding beyond limited use. There would be monetary speculation in that promise, but the incentive to create the infrastructure and apps that turned a network invention into today's massive, disruptive World Wide Web would have never been realized.

That is where cryptocurrency is today in terms of marketplace transactions. The promise is there, **but the infrastructure will not get built unless cryptocurrency can act as a reliable currency.** With a reliable cryptocurrency, a decentralized blockchain follows with even greater potential for disruption and positive change. This is the subject of Gilder's new book, *Life After Google*.

The crypto community needs to decide whether it wants a crypto plaything with speculative returns offset by a short shelf-life. Or do they want to realize the promise of cryptocurrency and the blockchain and create a decentralized stable currency beyond the control of government and elites that unleashes the next wave of human potential?

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I closed my reply with this:

Why is this necessary since Bitcoin is already accepted despite its faults? Because gold's earthly supply will someday be reached, and mankind will still require an unchanging monetary reference. **Virtuous human progress demands an unchanging monetary reference. There is no way around it. The blockchain offers a technological solution. I believe it is the natural evolution.**

Part I Notes on The Bitcoin Standard