Bitcoins: The Road to Investment Hell Is Paved With Good Intentions.
Gary North - December 03, 2013

Recently, the *Economic Policy Journal* ran an article, "Is Bitcoin Money: What Economists Have to Say." See Appendix. The editor asked a dozen economists. Two said "yes, Bitcoins are money." Here is the answer of one of the "yes" economists.

Yes. Bitcoin is money because it is limited in amount by internal characteristics enforced by the laws of mathematics and thermodynamics that is not subject to counter-party risk or anyone's liability and it also functions as a currency because it acts as a medium of exchange.

I had never heard of the gentleman. I can say this: nothing in his defense of Bitcoins as money is even remotely Austrian. **It ignores the market.**

The other one defended her "yes" position with a statement about what money is, not what Bitcoins are.

Money becomes real when people have faith in it. Governments have no monopoly on that which is why they spend a lot of time putting many symbols of faith and trust on the currency from pictures of sovereigns like the Queen or the President to hidden symbols of power like pyramids and seals. They would not need to if it stood on its own. Faith can be earned and it can be lost. The problem with bitcoin is that people are afraid a power outage or a hacker or bad management could erode or destroy the value of a bit coin. But, then again, governments are doing their best to erode confidence in fiat money too.

Everyone else said "no."

There are public defenders of Bitcoins. Several are mostly libertarian programmers. They do not appeal to economics or to economic history. They appeal instead to the good intentions of the programmers who are using Bitcoins.

What I am waiting for is a detailed defense of Bitcoins from an Austrian school economist or economic historian. I want to see how the Bitcoins market corresponds with the Austrian school's thesis of **the regression theorem**: money as a market product that has come in response to the transition of a widely used commodity into money.

The defenders of Bitcoins must deny the Menger-Mises regression theorem. They must affirm what Hayek called **constructivist rationalism**: the imposition of a man-made plan to create a new social order. He associated this impulse with the state. But defenders of Bitcoins say a genius created a new money.

Here is this thesis, as stated by programmer Paul Rosenberg.

Gary begins by quoting old definitions of money. There is nothing particularly wrong with those definitions, but are they supposed to negate progress for all time? To freeze the world in place? Should they make any new adaptation evil? I hardly think that was their intent.

Here it is, in no uncertain terms. The Menger-Mises regression theorem was good for its day, but we live in a New World Order, a world of digits. Now we must abandon the old Menger-Mises theorem.

He quoted me:

Here is the central fact of money. Money is the product of the market process. It arises out of an unplanned, decentralized process. This takes time. It takes a lot of time. It spreads slowly, as new people discover it as a tool of production, because it increases the size of the market for all goods and services.

He says that "Bitcoin is nothing but the operation of market forces -- there is zero coercion involved." True. But it is not money.

"Bitcoin is utterly decentralized -- there is no center at all." True, but it is not money.

"Bitcoin is utterly unplanned -- it involves a million people, all doing their own thing." True, but it is not money.

As for speed, the Bitcoin idea was created in the 1990s and has been implemented for almost five years. How slow is slow enough?

Think of this! Almost five years! But are Bitcoins money? No.

Bitcoin is not being used as money. It is being used as an investment asset. It is in the midst of a mania -- the desire to hold digits, in order to make money in dollars. Digits are the asset. The dollar is money. It is not the other way around.

He quotes me:

No one says, "I think I'll invent a new form of money."

Then he responds: "Yes, they do! That's precisely what the first person to use gold did!"

First, he is making this up. He has no idea what the first person who used gold as money did or thought. His version is based on constructivist rationalism. One lone genius thinks he will change the world by inventing money. He does it.

He did it, according to Menger and Mises, by using a commodity that was already in heavy demand by the free market.

Second, Rosenberg could as easily have begun with the person with no gold. He had something to sell, but he could not find a trading partner who had anything he wanted to buy . . . except gold. He said, "I will take gold in exchange." The other person agreed. We have no way of knowing which of them said, "I think I'll invent a new form of money." I think it is likely that neither of them did. They just worked out a deal.

Third, he adds this.

I'm sure some people will think of Bitcoin as an investment (which it is not) or that it is an arbitrage vehicle (which it is not) and will do stupid things. Some people always do stupid things. So what?

It is clearly an investment. It is in a mania stage. He can close his eyes, clap his hands, and say "Tinkerbell is not an investment," but she is.

I and many others have been saying that **Bitcoin is a crypto-currency, not an investment.** We've also warned incessantly that it is new and has enemies. In a How to Use Bitcoin report we issued just last week, we said "This is not a place for the timid," and, "There are no guarantees."

Mr. Rosenberg calls himself a cryptohippie. He runs a cryptography service called Cryptohippie (www.cryptohippie.com). My assessment: its name targets a narrow audience: hippies who are interested in crytography and privacy. This is not the average Joe.

If the average Joe does not use a supposed currency to buy most of the things he buys, then it is not a currency. This is Austrian school monetary theory. Accept no substitutes!

Rosenberg writes:

Bitcoin is not important because its price is rising -- it's important because it takes the control of money away from the cartel.

Concern with the dollar equivalent is a fetish, a distraction. The purpose of Bitcoin -- the intent of Satoshi -- is not to play price games, but to dis-empower the fiat cartel.

He also writes: "The purpose of Bitcoin -- the intent [of] Satoshi -- is not to play games, but to dis-empower the fiat cartel."

The intent of Satoshi Nakamoto, who Rosenberg says has disappeared, is economically irrelevant. Only geeks have heard of him. The crucial economic issue is the imputation of value by investors and owners of Bitcoins. What motivates them? A fast buck! A lot of fast bucks! **Bucks are money. Bitcoins aren't.**

We know this from its volatility: the desire to own an investment asset class that promises to vastly outperform any other asset class.

The programmers and cryptographers are on the sidelines, telling us that this is all about this or that or the other. But the markets tell a different story. This is a mania. Bitcoins did not go from a price of $50 for 10,000 in 2009 to the price of an ounce of gold in late November 2013 based on what the mysterious Mr. Nakamoto thought he was doing.

To the cryptographers who want to be Austrian school economists, I say this: begin with Menger and Mises on the origin of money. Do not begin with Mr. Nakamoto.

Note: he is now a billionaire -- in dollars. Bitcoins have been very, very good for him.

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"I, Broken Pencil": An Economic Analysis of Bitcoins
Gary North - December 06, 2013

Reality Check

In 1958, Leonard E. Read wrote an essay, "I, Pencil." He did not know it at the time, but this article soon became the most important description of the division of labor that has ever been written. It is not as famous as Adam Smith's description of the pin makers, but analytically, it is far superior. It is also a lot more fun to read.

The article begins with the narrative of a pencil. The pencil tells of his origin. He makes the crucial point that **nobody knows how to make a pencil**. This seems fantastic. Yet, as the narrative continues, it becomes obvious that the statement is true. There is so much that goes into a pencil. There is wood, carbon, rubber, metal, and paint. There is also all of the equipment to make these items into a single pencil.

But this is just the beginning. How is the metal made? How is the tree harvested? What about the chainsaws that cut down the tree? This goes on, and on, and on. That is the whole point of the article.

Read makes this point: **all this is done without central planning**. All of this is done by means of the division of labor.

But what Read doesn't mention, which is the heart of the matter, is the monetary system. It is only through a system of prices, meaning monetary prices, that all of this can be coordinated by the market process. It is the miracle of the market, as Read called it, but this miracle depends completely on one thing: a monetary system. **Without a monetary system, the division of labor simply collapses**.

VIRTUAL MONEY IN A REAL WORLD

Now let's talk about Bitcoins. Bitcoins exist as a means of payment only because there is not yet money in the general economy. **Bitcoins are a spinoff of the fiat money systems of the world.**

Bitcoins could not exist if there were not an integrated system of digital currency.

You have to have digital currency in order to buy Bitcoins. This digital currency leaves a record. Every purchase you make with the digital currency leaves a record. You are then told that you can make purchases with Bitcoins. These will not leave a record. As long as you never have to reenter the monetary economy of the government's fiat money systems, there is no further trace of your purchases with respect to digital entries.

But this creates a problem for the person selling you something. If the item that he sells you is manufactured, then he has to rely on the division of labor. He has to re-enter the world of fiat money currencies, meaning government run and central bank run fiat money currencies. He must convert his Bitcoins to real money. That is because he must buy real goods.

Bitcoins are virtual money. Problem: **virtual money buys very few real goods**. For virtual money to buy anything, the virtual money must be converted back into real money, which is digital money, which is money that is an entry in a bank account. At this point, all of the supposed privacy of Bitcoins disappears. Now the government can trace whatever happens.

In order for Bitcoins' promise of privacy to work, the division of labor must be exclusively governed by Bitcoins. **There must be no re-entry into the world of government fiat money.** The moment there is a re-entry into the world of government fiat money, privacy disappears. Whatever the economy has adopted as its pricing system, this is what every market participant, meaning the seller of a particular good, must deal with. He deals with the real world of real prices in real time.

This creates the philosophical problem of Bitcoins. That problem is known as the regression theorem. This was coined initially by Carl Menger, but it was developed by Ludwig von Mises. There has to be an extension from an existing price system to a new price system in order for a new currency to replace the old.

The problem for the defender Bitcoins is this: we need a comprehensive system of prices. For Bitcoins to work, they must be autonomous from the fiat money pricing system of the various government currencies. In order to make a pencil, there has to be a comprehensive, universal, widely recognized Bitcoins network. It is not possible to run Bitcoins as a separate currency system unless it applies to every product, every transaction, every service that is presently priced in terms of government monetary systems. Why is this? Because the division of labor must be integrated by a single currency system.

In order to make the pencil, everything must be priced in terms of Bitcoins: paint, wood, carbon, rubber, metal, and every raw material and every piece of capital equipment that was used to make the pencil.

UNIVERSAL PRICING

This is the whole point of Read's thesis. There has to be universal pricing. There has to be a profit-and-loss system governed by the universal pricing system in an integrated currency system. The only way for cross-currency transactions to take place is on the market. The most sophisticated futures market in the world is the market for currency futures. Every single transaction is recorded. Every single transaction is governed by written rules of the exchanges, as well as customary rules of exchange. The private property system and the entire legal system that undergirds the private property system come into play in order for the currency markets to operate.

Bitcoins' defenders do not openly say that there is no need for a private property system, no need for legal appeals, no need for any kind of arbitration system no need for contracts, no need for anything except algorithms. Yet they must assume this if they are to piggyback on the central banks' monetary system. Ours is not a world governed mainly by bits and bytes and algorithms. Bitcoin's is -- officially. **In fact, the whole system is a piggyback system. Theoretically, there is no personality in it. There's no person in it. There are no property rights in it.**

Bitcoins rests on a **religious confession of faith.** "The system will, without law or custom, and without enforceable property rights, autonomously evolve into a system with the same features and benefits as the present property rights order enjoys. It will do this without any intervention by the courts." This is faith in a unique god: the god known as algorithm. This god is known by his promise: "seamless transition."

Fact: there is no way to get the extraordinary division of labor that is necessary to make a pencil, unless the social and institutional framework, which is the foundation of all systems of real-world money, exists comprehensively.

A social framework is necessary -- a moral, intellectual, and legal framework -- to make possible the monetary systems of the world, which in turn make possible the modern division of labor. The advocates of Bitcoins do not discuss any of this. All they talk about is the vaunted privacy aspect of the system -- its independence from central banking.

There is more to free market exchanges than privacy. In fact, very few free market exchanges are private. Exchanges are based on contract and custom. There are court systems that enforce the contracts. There are methods of social pressure that enforce the customs. There are jury systems. All of this is foundational to the existence of the monetary unit, and the monetary unit is foundational to the entire division of labor economy.

Never in the history of libertarianism has there been any more utopian proposal that Bitcoins. **They rest on an implicit denial of the private property system**. They rest on an implicit denial of contracts and a denial of courts. They rest on an implicit denial of face-to-face resolution of disputes. They rest on an implicit denial of bargaining on a face-to-face basis. This is an implicit denial of virtually everything that exists in the free market society. The whole idea is delusional beyond anything I have ever seen.

Am I exaggerating? No. The Bitcoins system has no customs, courts, legally enforceable contracts, no resolution of disputes. All it has is algorithms. Yet its defenders say that the system is an extension of the free market's social order. It is in fact a denial of such an order. Its defenders think the Bitcoins markets can do without the social order that brought capitalism into existence a millennium ago. It is a classic free rider. Yet they insist that their system can replace the present capitalist order.

This is a programmers' fantasy.

GETTING FROM HERE TO THERE

Here is the problem in one sentence: a modern division of labor economy is very close to all or nothing. You cannot have a monetary system that does not apply across the board, yet still defend the concept of the division of labor through competitive pricing. You cannot have a currency that applies to illegal drugs, programming services, and almost nothing else, and expect that currency to replace the existing currency, which is a fiat money-based currency. There has to **be a transition from the fiat-based currency, in which there are hundreds of billions of transactions a day worldwide, which in turn provides a comprehensive system of pricing and information feedback, in order for the present system of the division of labor to be maintained.**

Any suggestion that Bitcoins can move from the modern system of integrated currencies, prices, and contracts, to get to an equally comprehensive system in which you could make a pencil, without the pricing system that is provided by the existing fiat money order, is simply utopian.

The utopians who are promoting Bitcoins are arguing that this virtual monetary system is going to replace the modern world's monetary system. But in order to do this, the Bitcoin system is completely dependent on the central banking monetary system. Bitcoins are a supposed haven from central banking. This is such utter nonsense that it is hard to believe that anyone can say it with a straight face.

No one can sell you a Bitcoins-produced pencil. A pencil takes real money to buy its component parts. If you can offer him only Bitcoins, he must convert these Bitcoins into real money -- fiat government money -- in order to buy the real goods. You cannot go from real money to virtual money, which buys only virtual goods, and then use this virtual money to manufacture real goods in the real world. You cannot make a pencil, because you do not have a comprehensive, integrated pricing system based on Bitcoins. Until almost everything is priced in terms of Bitcoins, and only Bitcoins, you get the modern division of labor only with the present monetary system. You cannot get to the system of 100% Bitcoins without being dependent on central bank money -- today, tomorrow, and for decades.

The mania will not last for decades. The bubble will pop.

All the talk of Bitcoins' privacy is nonsense. **Real money is bank money**. The initiating purchase of Bitcoins and their final conversion to real money are going to be recorded, because in order to get from Bitcoins to real money, in order to get from the virtual coinage to real coinage, in order to get from virtual purchases to real purchases, and in order to get from utopia to reality, **you have to sell Bitcoins for digital dollars**. But as soon as you do that, you lose privacy. The IRS can get you. The Federal Reserve has still got you.

In between, all you have is a bunch of Bitcoins exchanges. Silk Road was shut down by the government. **Sheep Marketplace went down because of massive theft inside the system.** A hundred million dollars disappeared. The investors lost it all.

When your virtual money is gone, there is no appeal to arbitrators. There is no way to trace who did it. The money has disappeared for good.

Lesson: a fool and his virtual money are soon parted.

Rule: all digits are not created equal.

PRICING CAPITAL ASSETS

Mises argued in 1922 that socialism produces chaos. It has no pricing system.

The fundamental objection advanced against the practicability of socialism refers to the impossibility of economic calculation. It has been demonstrated in an irrefutable way that a socialist commonwealth would not be in a position to apply economic calculation. Where there are no market prices for the factors of production because they are neither bought nor sold, it is impossible to resort to calculation in planning future action and in determining the result of past action. A socialist management of production would simply not know whether or not what it plans and executes is the most appropriate means to attain the ends sought. It will operate in the dark, as it were. It will squander the scarce factors of production both material and human (labour). Chaos and poverty for all will unavoidably result.

Most of all, Mises argued, socialism has no means of pricing capital. There are no capital markets.

The same is true of the as-yet nonexistent Bitcoins economy. It cannot do without the pricing system provided by central banking. It cannot produce goods and services without converting Bitcoins' digital fiat money into the banking system's fiat money. **You cannot produce real goods with virtual money**.

You have no capital markets without the monetary system. Capital markets are all based on contract. Bitcoins are based on a rejection of contracts. Capital is based on responsible ownnership: public claims on assets, enforceable by law. Bitcoins are based on a rejection of enforcement by law.

Bitcoins relate only to consumer goods, and hardly any. Yet even these cannot be delivered by sellers without selling Bitcoins and buying dollars to fulfill contracts. Sellers cannot replace sold assets unless they have bank money to buy them in the real world economy. This economy operates in terms of real money, which today is central bank money.

Bitcoins represent zero threat to the central banks. Bitcoins are used by most owners as ways to make money: to buy more dollars than they paid. It is just another investment asset -- one based initially on a complete fantasy, namely, that Bitcoins will somehow remove people from central banking.

Bitcoins are valued in terms of dollars. **The mania is fueled by their rising dollar-denominated price. They provide an investment medium for high-risk speculators.** They are nothing more than a way to get into a tiny market, and then ride the wave up, as more people get into it. There is no payoff in terms of the economic value of autonomous Bitcoins that are held only because they will serve as an alternative currency. They are held as a way to make money by selling to the greater fools, who will pay real money -- dollars -- for them.

It's a tulip bulb market. It rests entirely on getting back into the dollar economy.

Bitcoins will have no impact at all on the monetary base. They will have no impact on the capital markets.

Capital is valued in terms of central bank money. Bitcoins will not change this, for they cannot reduce the size of the monetary base. They do not pull money out of the fractional reserve banking system. The quantity of real money is in no way affected. The investors remain in the central bank economy, in which capital is priced. Capital is not priced in terms of Bitcoins.

This is why Bitcoins' economy today cannot produce even a broken pencil. It is giving Bitcoins far too much credit to say that they can produce a broken pencil. There is almost no division of labor based on stand-alone units of Bitcoins. To move to Bitcoins' realm of virtual money for real products, other than maybe programming services, is a fantasy. It isn't going to happen. We need pencils. We need computers. We therefore need today's division of labor. If we need those things, we have to sacrifice privacy to get them.

The privacy provided by Bitcoins doesn't do you a nickel's worth of good, and it's going to cost you $1,000 per Bitcoin to buy that less than nickel's value. You lose privacy as soon as you buy Bitcoins, because there is a record in your bank. The person who sells you something loses his privacy, because he has got a convert the Bitcoins back into a bank account. That leaves a record.

In the world of Bitcoins, there is no meaningful privacy, because you must surrender it to get back your dollars -- real money. There is no rule of law. There is no customary behavior. There is no pricing system. It is all a gigantic fantasy.

CONCLUSION

What went wrong with Bitcoins? Nothing. They started out wrong -- wrong conceptually (virtual money in a real world), wrong legally (no contracts and courts), and wrong with respect to their future market (tulip mania). They were from the beginning just another asset class, denominated in bank money. This has not changed. This will not change.

Bitcoins are the product of socially naive programmers' fantasies. They thought they could substitute algorithms for ethics, digits for legality, anonymity for custom, and dreams for responsibility. Ultimately, they thought they could substitute impersonalism for personalism.

They were wrong. They merely launched a tulip mania.

If the advocates of crypoto-currency have a case for a free market social order, then they should advocate not buying Bitcoins until such an order exists. Money develops out of a social order. They have put the cart before the horse: a new monetary system before the institutional arrangements to support it. This was Mises' argument regarding the regression theorem. A comprehensive monetary order that will replace the existing one is not going to be designed by obscure programmers. It will be the product of human action within a prevailing social and legal order.

To imagine that people can invent new institutional arrangements as extensions of the prevailing social order is legitimate. Let's see these alternatives first. Then they can tell us about their algorithms.

Libertarian utopians, having failed to develop these institutions, now have adopted what they see as a shortcut. They predict that a supposedly non-central bank money (it isn't) to create their new social order (it won't).

A replacement social order will not be tacked onto a revolutionary new monetary system, which is based an appeal to a nonexistent privacy. The monetary order must flow out of existing social and legal arrangements. But the programmers think they can reverse the regression theorem. They think we must start with a new monetary order, and then we can design the appropriate legal institutions. F. A. Hayek had a phrase for this:**constructivist rationalism**. It was better described by his friend Karl Popper: **piecemeal social engineering**.

Include me out.

Mises had it right in 1920: **the key factor in the free market's division of labor economy is capital pricing**. Until Bitcoins' market has priced all capital, but without resorting to central bank money, they will remain just another libertarian utopian fantasy.

Until there are contracts and courts in the Bitcoins world, Bitcoins will remain a conceptual delusion -- one inherently opposed to Mises' conception of capitalism's pricing system.

Bitcoins are anti-Austrian to the core. The fact that libertarian utopians do not see this indicates that they have never understood Mises or Austrian capital theory. This is not surprising. They do not even understand Leonard Read's "I, Pencil."

(There will be a hundred angry online rebuttals by programmers, published on obscure websites. They will insist that I do not understand Mises. Make up your mind after you read at least one critical response by an Austrian school economist who has written at least one book. Meanwhile, read mine:*Mises on Money*.)

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Digital Tulips: The Bitcoin Mania
Gary North - December 03, 2013

Remnant Review

In 1637, the tulip bulb investment mania peaked in Holland. It had made some people rich. Now it was about to make others poor.

Bulb prices rose steadily throughout the 1630s, as ever more speculators wedged into the market. Weavers and farmers mortgaged whatever they could to raise cash to begin trading. In 1633, a farmhouse in Hoorn changed hands for three rare bulbs. By 1636 any tulip--even bulbs recently considered garbage--could be sold off, often for hundreds of guilders. A futures market for bulbs existed, and tulip traders could be found conducting their business in hundreds of Dutch taverns. Tulip mania reached its peak during the winter of 1636-37, when some bulbs were changing hands ten times in a day. The zenith came early that winter, at an auction to benefit seven orphans whose only asset was 70 fine tulips left by their father. One, a rare Violetten Admirael van Enkhuizen bulb that was about to split in two, sold for 5,200 guilders, the all-time record. All told, the flowers brought in nearly 53,000 guilders.

Soon after, the tulip market crashed utterly, spectacularly. It began in Haarlem, at a routine bulb auction when, for the first time, the greater fool refused to show up and pay. Within days, the panic had spread across the country. Despite the efforts of traders to prop up demand, the market for tulips evaporated. Flowers that had commanded 5,000 guilders a few weeks before now fetched one-hundredth that amount.

The story is here.

What goes up comes down. Whatever offers fabulous riches for no good reason then offers fabulous losses for a very good reason: no new buyers at higher prices, and then a wave of selling.

Bitcoins that sold for $2 two years ago were selling for $1,242 on Thursday, November 29. Then they fell by a third in three days. Then there was a rally.

Volatility? Like nothing ever seen before.

Would you bet your future on Bitcoins? Would you hold 90% of your wealth in Bitcoins instead of dollars? No? Neither will anyone else. That is why Bitcoins will not replace the dollar or any other currency. An asset that traded for [$50 for 10,000 units] in 2009 is just too volatile. Multiply $1,242 by 10,000; that is $12,420,000. If you asked the buyer, he would say this: "Bitcoins have been very, very good to me."

Eat your heart out, Warren Buffett! It was all so easy. Just buy and hold.

That strategy is why Bitcoins will never become a replacement currency for the masses. Felix Salmon explains why.

This is something which should worry the bitcoin faithful, if they really want to see bitcoin become a broadly-used global currency. **After all, press coverage of bitcoins runs in lockstep with the bitcoin price: it's times like this, when the price is at its fluffiest, that bitcoin gets written about the most.** (If it's not physical bitcoins, it's hard drives in landfills.) The largely unspoken assumption behind all such stories: bitcoin is an asset class, and people should get excited about it when (and, implicitly, only when) the price is going up. This is what I think of as the CNBC Premise: when an asset rises in price, that is necessarily a Good Thing, and when it falls in price, that is always a Bad Thing.

The CNBC Premise has never made much sense with respect to currencies, however. And with respect to bitcoin in particular, its most exciting aspect is not its value, but rather its status as an all-but-frictionless international payments mechanism. If you want bitcoin to really take off with respect to payments, you actually don't want to see crazy price spikes -- such things are the best possible way of stopping people from using bitcoins for payments. After all, if your bitcoins are doubling in value every few days, why on earth would you want to spend them?

EVERY MANIA HAS DEFENDERS

I am writing this response to a critic of my criticism of Bitcoins.

He dismisses me as if I am an economic ignoramus. He is not the first. I always have fun responding. He says of me that "his arguments diverge from Austrian economics." This, I must admit, is a new twist. I have not faced this accusation in the past.

I must respond. If an author does not respond, some of his followers may think he cannot respond. Trust me. I can respond.

Let me say from the beginning that I have never heard of the author, John Mather. His article was introduced by Jeffrey Tucker. Mr. Tucker was wise enough to get a stand-in for this hatchet job. "Let's you and him fight."

North purports to base his critique of Bitcoin on Austrian economic theory. **However, his arguments are so weak that he makes Austrian economics look bad, to the point that someone unfamiliar with Austrian theory could finish his article doubting the validity of Austrian theory.** One reader who linked North's article on a message board even commented that the article made him want to stop referring to himself as Austrian.

Rule: When debating seriously, save your rhetoric of condemnation for your conclusions. You may overplay your hand when you start this up front.

DEFINING MY TERMS

He begins with this.

Is Bitcoin a Ponzi Scheme?

In my article, I carefully defined how I was using the term. Here is what I wrote.

The individual who sells the Ponzi scheme makes money by siphoning off a large share of the money coming in. In other words, he does not make the investment. But Bitcoins are unique. The **money was siphoned off from the beginning.** Somebody owned a good percentage of the original digits. Then, by telling his story, this individual created demand for all of the digits. The dollar-value of his share of the Bitcoins appreciates with the other digits.

This strategy was described a generation ago by George Goodman, who wrote under the pseudonym of Adam Smith. You can find it in his book, Supermoney. This is done with financial corporations when individuals create a new business, retain a large share of the shares, and then sell the stock to the public. In this sense, **Bitcoins is not a Ponzi scheme. It is simply a supermoney scheme.**

The Ponzi aspect of it comes when we look at the justification for Bitcoins. They were sold on the basis that **Bitcoins will be an alternative currency. In other words, this will be the money of the future.**

The coins will never be the money of the future. This is my main argument.

Mr. Mather then goes on to develop at length his argument by applying Wikipedia's definition of a Ponzi scheme to my article. The Wikipedia article does not address my definition. Neither does Mr. Mather.

When arguing against a person's statements, it is best to quote his statements, not quote a Wikipedia article as a substitute.

I am willing to substitute **tulip mania** for **Ponzi scheme**, in order to keep Mr. Mather happy. As I said, the heart of my criticism is this: "The coins will never be the money of the future. This is my main argument."

FIAT MONEY

Here is the heart of my article: fiat money is money "spoken" into existence. It is not money developed over centuries of market transactions.

Bitcoins are wanna-be fiat money digits. They were spoken into existence. This is the characteristic feature of fiat money. Bitcoins are not yet money.

Because of the mania, they will not become money. **They lack money's characteristic feature: predictable value.**

1) North says Bitcoin is made "out of nothing." This is a specious argument.

On the contrary, this is a **specie** argument. I reject fiat currencies that are not the product of long years of use in the free market.

The fact is that the Bitcoin currency and payment network is comprised of computer code. Is the web browser you're using to read this article made out of nothing? That Bitcoin is not a physical good doesn't mean it is made out of nothing. Billions of people, including North, assign economic value to all sorts of things which have no physical form. The most obvious example aside from the computer code of companies like Google or Apple is the vast supply of US dollars, the majority of which exist only in digital form.

My reference is to the fact that Bitcoins were created out of nothing to perform a service. This service is to replace fiat currencies with a new currency, which will replace fiat currencies in trade.

Unlike gold and silver, which became monetary units out of millennia of human action, Bitcoins were launched as a fiat currency that would become a new currency unit. My point is this: the volatility of Bitcoins' price is an indication of why they will not replace central bank fiat currencies, which are easily used in trade, and which are -- so far -- stable in purchasing power. This can change, but this is sure: dollars are used in trade by millions of people in billions of transactions.

The market has determined that the dollar is money. It has not determined that Bitcoins are money. The crucial factor in money is predictability of purchasing power. Bitcoins lack this.

2) North writes, "Something that was valuable for its own sake, most likely gold or silver…." Nothing is valuable for its own sake. All value is assigned. This is Subjective Theory of Value 101. North doubtless knows this, but it appears he's attempting to imply gold and silver possess some sort of intrinsic value.

Rule: when you are an unknown author, and you attack a well-known author who, ever since 1969, has been publicly defending the idea that gold does not have intrinsic value, you really do look silly if you use rhetorical arguments like this.

The man who wrote this is not a skilled debater. That is why I am cutting him some slack. My guess is that the author was not born when my first article on this was published in The Freeman. The article was titled, "The Fallacy of Intrinsic Value."

He then adds:

It may feel good to believe (especially if you own gold and silver), but it's just not true.

This young man thinks he is making a damaging attack on me by arguing that I in some way was arguing for the doctrine of intrinsic value, despite the fact that he writes, "North doubtless knows" that value is subjective. Yes, I do. So, why go into a discussion of what I "doubtless" know? The answer: rhetoric.

Rule: when rhetoric has no supporting logic, avoid it.

PROGRAMMERS' JARGON

The author then launches into a discussion of something he calls a "network effect." He uses the language of programmer instead of the economist. But he makes the same point I made in 1969: gold is marketable.

Gold and silver have many uses, for example in electronics or silver in water filtration. But most of the value of gold in particular is due to its marketability, meaning, the acceptability of gold by other market participants.

Yes, yes, yes. It's time to stop beating a dead horse. But he doesn't.

This acceptability is a mutually reinforcing process by which people are more willing to accept gold because others are more willing to accept it. The existence of a mutually reinforcing cycle of demand is known as a network effect. Some examples of other network effect markets are cell phones, fax machines, web browsers and web servers, cars/roads/gas stations, and fiat money.

The difference between network effect goods and direct use goods is that, for example, the enjoyment of a steak dinner does not depend on its acceptability or adoption by others. A direct use good directly meets an individual's needs, while a network effect good derives a significant part of its value from the network. Most goods we use today have some combination of both.

And on, and on, and on.

As the Austrian economist Karl Menger argued, money itself replaced non-money as a market network effect good.

Karl Menger was [Carl Menger's son](). Mr. Mather is confused here. I can assure you that Carl Menger, the founder of Austrian school economics, did not use language like this: "money itself replaced non-money as a market network effect good." No Austrian school economist ever has. Austrian school economists do their best to communicate in something other than programmers' professional jargon.

Network effects can come and go. An example is the adoption of fashion. A particular look can go in and out of style either very quickly or over a much longer time frame.

Now he's getting close. The "network effects" of gold and silver go back thousands of years. The network effects of Bitcoins as an alternative currency have yet to come.

FROM VOLATILITY TO MANIA

I argued that the extreme volatility of Bitcoins has killed the possibility that Bitcoins will become a currency.

Any time a once-popular good falls out of favor, does that mean it was a fraud?

No, nor did I say it was a fraud. I said it was not a fraud.

This author has a habit of putting words in my mouth, and then refuting these words.

3) North writes, "But Bitcoins are unique. The money was siphoned off from the beginning." By calling it money, North is contradicting himself. And unique? With every fiat currency, the state siphons off a portion of the money it prints. It's standard operating procedure.

I see. We should buy Bitcoins as money because Bitcoins' creators imitated the State.

Rule: when you're in a hole, stop digging.

With market money, early adopters have always profited from their foresight.

My point is that **Bitcoins are not market money.** I have not heard of market money profiting early users. There are no records of this. That is my main point in my article on "The Regression Theorem As Conjectural History," which I cited in my original article.

It is not a matter of being early adopters of a new fiat money. They are not adopting Bitcoins as users of money. They are in a tulip mania scheme. This scheme will keep Bitcoins from ever functioning as money. Bitcoins lack what money must have: **predictable purchasing power over an entire economy's goods and services**. Their value is wildly unpredictable.

Bitcoins went into mania mode so early that they will be tarred and feathered as a tulip mania launched by programmers who got rich with their invention, but whose invention will lead to huge loses by a lot of people. These two words will kill Bitcoins as future money: "Never again." Also these: "Once bitten, twice shy." "Fool me once, shame on you. Fool me twice, shame on me."

The creator(s) of Bitcoin may be sitting on lots of them; I don't know. But there's nothing unique about that. Early adopters also take on a lot of risk. The founder of every multi-billion dollar company had mountains of stock at the company's inception. That doesn't mean money was siphoned off. What is unique about Bitcoin compared to all fiat currencies is that there is a hard limit on how many currency units can be created/mined. Fiat money can be replicated instantly without limit on central bank computers.

Notice what he is doing. **He is using my argument against me, yet he presents it as if it were**

his own original argument. I wrote this:

This strategy was described a generation ago by George Goodman, who wrote under the pseudonym of Adam Smith. You can find it in his book, Supermoney. This is done with financial corporations when individuals create a new business, retain a large share of the shares, and then sell the stock to the public. In this sense, Bitcoins is not a Ponzi scheme. It is simply a supermoney scheme

Rule: when you try to score a debating point by quoting your opponent's exact argument, skip this point.

4) North observes, "Money develops out of market exchanges." Yes, and that's what is happening with Bitcoin. People began using it from the beginning knowing it was not money by the Austrian definition as the most widely demanded commodity. Yet they kept using it for market exchanges. They could do so because Bitcoin is also a payment system which allows secure peer-to-peer transactions with no third party fees. That feature in and of itself has great utility. If Bitcoin becomes money by the Austrian definition, it will be because it developed out of countless market exchanges.

Here is my point: **Bitcoins are not being used in market exchanges. They are merely a tulip mania craze in which people are buying them with dollars in order to sell later for dollars. That is why they are not money.**

5) When North proclaims, "Bitcoins cannot serve the consumer. There is nothing to consume," he makes an absurd statement. As if a customer cannot be served without consumption! When was the last time North consumed a gold coin? Never, because gold is not consumed. Even if it's made into jewelry, it can be refashioned into coins or any other form.

I really do know the difference between consumption as "using up something" vs. gold as a consumer good that is "used by not using it up." For decades, anti-gold standard pundits have said: "You can't eat gold!" I responded to this in 2004 in my article, "You Can't Eat Gold!" I had written similar pieces for over 30 years by 2004.

Rule: When you're in a hole, stop digging.

6) North continues with more nonsensical statements: "But the fundamental characteristic of money is its relatively stable purchasing power." Stable purchasing power is desirable in a money, but it is most certainly not the fundamental characteristic of money. Rather, the fundamental characteristic of money is that it is the most widely demanded commodity in a given economy.

And why is it the most marketable commodity? (Hint: it has something to do with predictable purchasing power.)

Rule: When you're in a hole, stop digging.

North keeps pointing to the US dollar as money, yet even the US government's inflation calculator (which statistically "adjusts" the real figures lower) shows that since 1988, the US dollar has lost half its purchasing power. In my grandmother's lifetime, the US dollar has lost over 96% of its purchasing power. Several goods over those periods have had more stability in their exchange power for other goods than the US dollar. If stable purchasing power were the fundamental characteristic of money, then the US dollar would no longer be money.

Year to year, the dollar is relatively stable. That is why it is money.

North frequently in his writings points to gold and silver as the most desirable money commodities. Yet the price of gold went from $35 to $1,910/oz. Perhaps upside volatility is acceptable to North, with the exception of Bitcoin of course.

I have argued that gold is not money. I presented my case in 2003: "The Re-Monetization of Gold." I wrote: "That's why I do not expect to see gold as money in my lifetime. But I still recommend gold as an investment."

He thinks I am using a straw-man argument.

7) North goes on to set up a straw man argument, framing Bitcoin not as an open source international currency and payment system, but rather as a mania-driven, against-and-dump investment.

Mania-driven? Yes. Pump? By definition: the ultimate private fiat money pump. Dump? No. Strategic sales to each new wave of investors? Yes. They created millions of digits for some programming costs. They are worth billions on paper . . . in dollars.

He writes, "Whenever somebody tries to sell you an investment that is based on the economic analysis of a market -- an analysis that cannot possibly be true -- do not buy the investment."

Then he again affirms what I explicitly denied:

Now that his monetary theory arguments regarding Bitcoin have failed, he points to the rapid price increase in Bitcoin as evidence that Bitcoin itself must therefore be fraudulent.

I said that it is not fraudulent.

He goes on.

Perhaps Bitcoin is in a bubble and the price will crash.

There is no "perhaps" about it. This is a digital tulip mania.

Maybe it will be overtaken by another crypto-currency some day. Perhaps the rapid price increase is pointing at an acute worldwide demand for a secure, borderless, person-to-person, expense-free form of payment. The fact is nobody knows why the price of Bitcoin is what it is right now, or what it will be in the future. For North to claim he does, and importantly, for him to use Austrian economics as the basis for his claim, is unfounded and misleading.

It is neither unfounded nor misleading.

When a good is adopted as money, its value goes up because it is adopted as money. And unlike yielding assets, there is no way to say that it is over-valued because you can't calculate a yield.

True. But if you see a non-money asset marketed on the basis that it will become money someday, and it rises from $2 to $1,250 in two years, you can draw conclusions. Here is mine: this is a tulip mania.

8) A final piece of Northian Ponzi logic masquerading as sound argument: "The mania has destroyed Bitcoins' use as money. Bitcoins are too volatile in price ever to serve as a currency. Which is money: dollars or Bitcoins? The answer is obvious: dollars." So to follow his line of thinking, US dollars are money. Agreed. Yet every single fiat currency throughout history that has hyperinflated into oblivion was money by North's standard before its hyperinflation. Going from money-status to worthlessness is the most extreme case of volatility -- terminal volatility so to speak. Bitcoin has not done that -- quite the opposite -- making North's argument contradictory. Once the US dollar has lost 99% of its purchasing power (rather than the 96+% my grandmother has suffered), will it still be money? Further, if one defines a currency as a medium of exchange, we see that Bitcoin is used many thousands of times per day in exchange for thousands of different products and services. So in that regard it already has been and continues to "serve as a currency."

I see. Thousands of transactions per day. He offers no proof, but I will accept this estimate. Maybe 5,000. Maybe 10,000. He does not know. He cites no source.

How many transactions per day are there in dollars? No one knows. But the flow of funds is around $14 trillion. That is because the dollar is money. Bitcoins are not.

Now he invokes "I don't know."

It is true that if the exchange rate of Bitcoin continues to be highly volatile indefinitely, bitcoins will be ill-suited as a currency over the long term. But Bitcoin is still in its infancy.

It has become a tulip mania in its infancy. It's doomed. It will not escape this digital mark of Cain. "So, you got sucked in. What were you thinking of?" Volatility is the kiss of death for currency. When a currency isn't a currency, a mania will kill its reputation.

During the adoption phase of any good as money, the purchasing power rapidly increases from its initial value as a non-monetary good as more and more people adopt it.

He is making this up. There are no records of any such private fiat money in history. All fiat monies have been extensions of previous government money systems or a previous commodity standard.

Only time will tell if Bitcoin is currently in a bubble or undergoing adoption as money. If it were to, say, triple from here and then stabilize, clearly this period would not be viewed in retrospect as a bubble.

"Only time will tell." That's it? This is Ben Bernanke on housing prices in 2005. But housing prices had not gone up by 600 to one in two years.

He says that if it triples and then stabilizes, this will convert the biggest bubble in American monetary history into a non-bubble. Then Bitcoins will become currency.

My point is this: it cannot stabilize. The mania will reverse. The price will collapse. Its wild swings will continue.

In short, this time it's not different.

TECHNICALLY BETTER THAN GOLD AND SILVER

Then he goes on to say that Bitcoins -- five years old -- already stack up well against gold and silver.

Here he goes into the outer regions of space cadet analysis. He simply ignores the entire history of monetary economies.

It is inherently scarce by virtue of the underlying cryptographic math which sets a hard limit of 21 million bitcoins. As the total already-mined supply increases toward the limit, additional bitcoins can only be mined with ever-increasing difficulty. In this respect, Bitcoin is different than gold and silver which, while difficult to produce, do not have a known cap on their production. There is no guarantee, for example, that large undiscovered deposits of the metals could not exist. . . .

Uniformity: Bitcoin is superior to gold and silver because both metals are easily adulterated. One of the ways gold and silver coins were inflated in the past is by debasing them with more common metals. The Roman denarius initially was almost pure silver, but subsequent regimes continually debased the denarius until it only contained 2% silver. A metallurgist can for a fee tell you with a high degree of confidence if a coin or bar contains the purported concentration of gold or silver. A layperson cannot. In comparison bitcoins are completely uniform, and there is no mechanism by which they can be adulterated in the way precious metals can.

Conclusion: Durability: It would seem at first glance that gold and silver would win hands down, but I submit that Bitcoin actually wins. It's easy to dent and scratch gold, yet to its credit gold is practically indestructable. But if a gold coin gets badly banged up or bent, a vendor would likely hesitate to accept it. Sure an expert can assay the metal content of the damaged coin for a fee, so it is durable in that sense. But Bitcoin has a different, and arguably more practical, sort of durability. Namely, you can make any number of perfect backups of your bitcoins. While a USB thumb drive containing one's Bitcoin wallet is susceptible to breakage, that wallet can be stored on any number of other digital storage devices. This provides for a kind of durability that gold and silver cannot offer. You can have your bitcoins with you on a mobile device, on a thumb drive in a secure spot at home, even perhaps stored in another state or country in case of local disaster.

This is a computer programmer's answer to monetary history.

How strong is his summation? You judge.

I have focused on gold and silver because of their historical importance as money, because North focuses on them in his writings, and because the Austrian school has a lot to say about them. If I had to choose a commodity money, it certainly would be gold and silver for the reasons outlined above. My purpose was not to suggest that they are unsuitable as money, but rather to show that Bitcoin shares, and in some cases exceeds, the traits which make gold and silver good forms of money.

Yes, the Austrian school has had a lot to say about gold and silver.

LEGAL TENDER

He takes a new tack.

If Bitcoin can never be money for the reasons North argues, how is it that the US dollar has been money for so long while violating North's own self-imposed standards? Legal tender laws aren't a valid answer because legal tender laws have not stopped other fiat currencies from becoming worthless.

What has legal tender got to do with anything? Legal tender laws apply only to Federal Reserve Notes and coins. Most of these notes are outside the United States. Furthermore, no one has to accept them. The U. S. Treasury says this.

The pertinent portion of law that applies to your question is the Coinage Act of 1965, specifically Section 31 U.S.C. 5103, entitled "Legal tender," which states: "United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues."

1. This statute means that all United States money as identified above are a valid and legal offer of payment for debts when tendered to a creditor. There is, however, no Federal statute mandating that a private business, a person or an organization must accept currency or coins as for payment for goods and/or services. Private businesses are free to develop their own policies on whether or not to accept cash unless there is a State law which says otherwise.

http://www.treasury.gov/resource-center/faqs/currency/pages/legal-tender.aspx

He is unaware of all this.

He is unaware of a lot of things, as I have shown.

Most of all, he is unaware of the basics of debate, especially this: **When you are in a hole, stop digging**.

Mr. Mather and the other Bitcoins defenders are kids. Worse -- a lot of them are programmers. Old timers can see what's coming. This is the biggest tulip mania in history.

You can read his article here.

http://www.garynorth.com | Home

Showdown: Bitcoins vs. Greenbacks and/or Precious Metals

Gary North - December 10, 2013

Reality Check

There are conflicting stories among Bitcoins' supporters about why a Japanese programmer or team of Japanese programmers, who are known by a pseudonym Satoshi Nakamoto, developed the original idea for the Bitcoins software.

The primary justification for Bitcoins among libertarians is the prediction that Bitcoins will become an alternative currency to all existing central bank currencies. Bitcoins are seen as a first-stage revolt against central bank money.

In this essay, I'm going to make a series of arguments. I'm going to tell you in advance what my arguments are. You can then judge whether or not I have been successful in presenting my case. Here are my arguments.

First, the primary benefit that libertarian promoters of Bitcoins offer in justification of their theory that Bitcoins will become an alternative currency is this one: Bitcoins offer privacy. Paper money today offers a much greater degree of privacy that Bitcoins do, plus a whole series of other major advantages that Bitcoins do not offer.

Second, money is the most marketable asset. Paper money is vastly more marketable than

Bitcoins.

Third, gold-based and silver-based digital currencies are more likely to become future world digital currency than Bitcoins.

Fourth, most Americans do not want privacy in their exchanges. This is manifested by the fact that they do not use the form of currency in which privacy is easily available and totally legal: greenbacks.

I will compare the advantages of Bitcoins with the advantages of greenbacks. I will then compare the disadvantages of Bitcoins with the disadvantages of greenbacks. Then I will compare Bitcoins to digital currencies that are backed by either gold or silver.

1. PRIVACY

Here, I discuss the price of buying privacy.

Greenbacks. There are three ways that anyone with a bank account in the United States can obtain greenbacks. First, he can walk into his bank, fill out a request for greenbacks, hand it to the teller, and the teller will hand over a specific quantity of paper money. Second, he can drive up to a booth in the bank's parking lot, put a check into a tube, put the tube back into a reception box, and within a couple of minutes, the tube will come back with a specified amount of paper money in it. Third, an individual can walk over to an ATM machine, specify how many dollars he wants, run his bankcard through the machine, and will immediately receive his paper money.

All three approaches raise no eyebrows. All three approaches are quite conventional. The banks promote the use of ATMs, because they eliminate tellers' labor time. ATMs are available in many locations. There is nothing controversial about them. They are easy to use, and most people who have a bank account know exactly how to use them. There is almost no learning curve involved.

As soon as an individual has paper money, he has total privacy. He also has total control over his money. He knows where the money is. He decides where the money will go. He decides how long he will keep the money. He can of course be robbed, but this is relatively rare.

He now has perfect "privacy money." He can go into any retail establishment in the United States and buy whatever he wants if he has enough money. In all likelihood, these purchases will be limited to no more than a few thousand dollars. Purchases of anything that costs more than $10,000 will probably be avoided, because there are reporting requirements for these purchases. But very few people ever make a purchaseof more than a few thousand dollars.

For any legal purchase, he can receive a receipt from the seller. This establishes the base price of whatever it is that he purchased. There's nothing controversial about asking somebody for a receipt. He does not have to ask for receipt, but he can. He also knows where the seller's place of business is located if it is a retail business.

He has a virtually unlimited number of establishments from whom he can make the purchases. That is to say, **he enjoys all of the advantages of the digital money system with respect to the division of labor**. He knows what anything will cost, because the price is denominated in digital money, and the purchasing power of paper money is as high as the purchasing power of digital money. In fact, in some cases, the purchasing power is higher. People will sometimes negotiate for payment in currency, because they do not intend to report the income to the Internal Revenue Service. They will therefore offer discounts for anyone who is willing to pay cash. When you have paper money, you can often negotiate for a better price, although of course not it in a store that uses electronic cash registers.

Once the money leaves the bank, no government agency knows what an individual does with his money. He has total privacy. His expenditures will leave no paper trail, unless he wants to create it by asking for a receipt.

There is nothing controversial about taking out currency. It draws no attention to itself. The government has no idea or interest in what the person who withdraws the money does with this money. It is just a routine transaction -- lost in the noise. It is the kind of transaction that has gone on in banking circles from the beginning of banking. It is basic to all banks that some people make withdrawals of currency.

So, with respect to privacy, currency is true privacy money. It is close to invisible to the government at the point of initiation: an ATM. It can be spent anywhere. It leaves no traces. It draws no attention to itself.

Bitcoins. Almost nobody knows how to buy Bitcoins. The person must buy them through a Bitcoins currency exchange company. He has no idea which ones are reliable. He risks getting into a Bitcoins-related Web business like Silk Road, which the government shut down. He risks getting into an exchange like Sheep Marketplace, which was hit by a $100 million heist, and which shut down, leaving its users with a 100% loss. There is no way to prosecute. There is no way for a depositor to get his digital money back. He bought secrecy with respect to any police agency, so nobody can find out where his money went, and he has no legal claim against anybody.

He has to know how to use computers to get access to this kind of money. Not many people know how to do this online. In other words, **there is a huge learning curve involved in gaining access to this privacy money**.

Conclusion. Here is a fundamental economic rule: **as the price of anything increases, less is demanded**. The information cost of discovering how to gain access to Bitcoins is high. The information cost of discovering how to use an ATM machine, or a drive-through bank teller system, or walking into a bank and withdrawing currency is about as close to zero as imaginable.

Therefore, anyone who promotes Bitcoins is a viable alternative to greenbacks is ignoring the following: (1) the low information costs of gaining access to greenbacks; (2) the complete lack of interest on the part of the government or the bank in withdrawals of a few hundred dollars at the time; (3) a market for this currency that is essentially the same as the market for digital currency; and (4) the possibility of negotiating discounts for purchases with this currency.

2. MARKETABILITY

Here, I discuss the Austrian school's definition of money: the most marketable commodity.

Greenbacks. If you own dollars in the form of paper currency, these dollars are available for use in any retail establishment. You can go into Walmart, Target, or any other retail establishment, and you can buy anything in that store for paper money. You will not be asked to show an identification card when you leave. No one will pay any attention to the fact that you are buying this with paper money. The person at the checkout counter will simply take your money, and issue you a receipt. You will walk out of the store with your receipt and whatever it is that you bought.

You can repeat this with any public utility. Paper money is familiar to everyone at a checkout counter. The employee will probably not examine the currency to find out if it is counterfeit. In other words, there are no transaction costs in using currency, other than driving to the retail establishment and driving home. But, with respect to buying with this currency, **there are no transaction costs**. There are no search costs. You do not have to search for which companies are willing to sell you something for your paper money. They all are.

The market for paper money is essentially the same as the market for digital money. There is no restriction on the use of paper money. The Federal Reserve System is behind its paper money. The Federal Reserve System is not going to limit the use of paper money. Its name is on the paper money. There is no hostility between the Federal Reserve System and paper money issued by the Federal Reserve System. There is no hostility by government agencies to the use of currency, as long as the currency is being used in statistically normal patterns, with respect to withdrawals. Because there are no restrictions on the use of paper money, no question is asked at a retail establishment regarding the use of paper money to make a purchase. Therefore, retail establishments constantly allow people to buy anything they want in the store with paper money. The market for paper money is coterminous with digital money within the geographical area under the jurisdiction of the United States government and the Federal Reserve System.

Bitcoins. You cannot use Bitcoins to buy anything in approximately 99.9% of American retail establishments. This is probably too low an estimate. You cannot buy what you want, when you want, where you want with Bitcoins. There are search costs involved in locating anybody who will sell you anything with Bitcoins.

When you walk into a retail store and ask if you can buy anything in the store for Bitcoins, the employee will not know what you are talking about. Almost nobody in the store will know what you are talking about. There is no checkout counter that converts Bitcoins into digital dollars, and then issues you a receipt for whatever it is you just purchased Therefore, Bitcoins have close to zero marketability.

The only way you can buy anything with Bitcoins is because the seller is going to convert the Bitcoins immediately into dollars. Bitcoins do not have a separate market that is not tied to the banking system. In China, on December 5, the People's bank of China issued new regulations on Bitcoins.

"Internet websites that provide bitcoin registration or transaction services should be sure to fulfill anti-money laundering obligations, identify user identities, request users to register with real names and provide information of names, identity card numbers, etc…. any clues related to using bitcoin for fraud, gambling, money laundering and other criminal activities should also be promptly reported to the police."

Bitcoins all over the world fell by one-third within a day. The peak had been a few days earlier: $1,242. They are in the low-$700s today. The volatility is gut-wrenching.

Therefore, hardly anyone is going to sell you anything for Bitcoins who does not have the ability to convert instantly those Bitcoins back into dollars or his own domestic currency. The risk of holding Bitcoins more than a few seconds is way too high for any retail establishment. So, for a retail establishment to be willing to sell you anything for Bitcoins, it must have a computer program tied to its bank in order to convert Bitcoins into dollars instantaneously. This means that the retail seller has to let his bank know that he is using Bitcoins. This means that, at any time, the Federal Reserve System can collapse the price of Bitcoins.

A joint announcement of the Federal Reserve, the European Central Bank, the Bank of England, and the Bank of Japan would complete the destruction. They could simply threaten expulsion from their respective banking systems for member banks that offered Bitcoins services. "Bitcoins, R.I.P."

Therefore, with respect to marketability, **Bitcoins are an extension of the central banking system**. They are in no way independent of the central banks. The Bitcoins market operates only at the discretion of the central banks. The central banks allow Bitcoins for the moment, and only because of this toleration by the central banks does any market for Bitcoins exist.

Conclusion. There is virtually no possibility that the Federal Reserve System is going to outlaw the use of Federal Reserve notes. There is always a possibility of the Federal Reserve System will prohibit banks from dealing with any retail company that uses Bitcoins in its transactions. The likelihood that a central bank will prohibit the use of Bitcoins is vastly higher than the possibility that the central bank will prohibit the use of the paper money issued by the central bank.

Therefore, the argument that Bitcoins can become a rival currency to paper money must rest on this hypothesis: the value of Bitcoins will be based at some point in time on a system of exchange that is 100% independent of commercial banks, and second, that the value of Bitcoins will be rising in terms of the national currency system, which is mostly a digital currency system. In other words, people will use Bitcoins as a means of exchange instead of using gold coins, silver coins, or digital money that is backed by either gold or silver.

3. THE LATEST SKIRMISH IN THE WAR ON GOLD

Proponents of Bitcoins are necessarily arguing that the unbacked fiat money that is produced by the Bitcoins system will be preferable to the vast majority of people who are attempting to escape the digital currencies of their central banks. Bitcoins will be favored, and digital currencies based on either gold or silver will be bypassed.

They believe that millennia of experience with gold and silver coins, and therefore with gold and silver as a means of exchange, will be abandoned by most people who decide to opt out of central bank currencies. In place of digital currencies backed by gold and silver there will be substituted widespread faith in a digital currency made available by unknown exchanges, which can be shut down, as the Silk Road was shut down, by a government agency, and which can be shut down by the owners of the exchange whenever convenient, with whatever digital money is inside those exchanges simply disappearing, as took place with Sheep Marketplace.

This argument relies on an assumption, namely, that the historic tradition of gold and silver as money will never be restored. Most people will voluntarily use a form of currency which is not tied to the precious metals: Bitcoins. In other words, thousands of years of tradition in India, thousands of years of tradition in China, thousands of years of tradition in the Far East generally, thousands of years of tradition in the Middle East, hundreds of years in Europe, and 350 years of tradition in the United States (Spanish pieces of eight to the de-monetization of silver in 1964), all count for nothing. Instead, a form of digital currency that is subject to government shutdown and massive theft -- a currency which nobody understands -- will be used in preference to gold and silver digital currencies and precious metals coins as an alternative to collapsing central bank monetary systems.

Buyers of Bitcoins are expected to accept incoherent explanations in choosing an alternative monetary system. Billions of people around the world will place their faith in this explanation. They must convert their central bank money into Bitcoins, based on this explanation of how it works. (Watch all of it. Don't quit. I dare you. I double-dog dare you.)

This is an argument that says that Bitcoins, which nobody understands, are preferable to gold and silver, for which there is a long-established tradition in the Far East, the Middle East, and the West. We are expected to believe that Bitcoins, which were invented by a team of anonymous Japanese programmers, and which are promoted mainly by libertarians who do not have much money, and by programmers who do not have much money, will become the money of the future, whereas gold and silver digital currencies and coins will never come into widespread use in exchange.

4. DEMAND FOR PRIVACY

Here, I consider the demand for privacy.

Greenbacks. The total amount of money in circulation outside of banks in the United States is approximately $1.2 trillion. If you divide $1.2 trillion by114 million households, you get about $10,000 per household in currency on hand.

There is no possibility that there is as much money in most American households. You don't have it. I don't have it. Then where is it? Economists at the Federal Reserve System have known for a quarter century where most of this paper money is. It is offshore. This money is remitted by Americans or residents of the United States who send paper money to the folks back home. United States dollars circulate as alternative currencies in Latin America and other societies. They are inflation hedges.

I challenge you to an empirical test. How much money do the members of your household have in the form of currency? The difference between what your family has in paper currency and the $10,000 that it ought to have, if all of this currency were distributed evenly throughout the American economy, is an indication of just how committed you are to owning money that is private. I contend that you are barely committed at all to privacy money. I could be wrong. I don't think I am wrong. Test my theory.

If you, as a suspicious critic of the Federal Reserve System, and also a suspicious critic of the United States government, are essentially uncommitted to a monetary system based on privacy, how much commitment would you expect to find among your neighbors? How much commitment would you expect to find in middle-class America? (I am not talking here about inner-city ghettos. In inner-city ghettos, where people do not have bank accounts, currency is common. But there is not much money in the households of inner-city residents. With respect to any significant markets in the United States, inner cities are marginal. They had been marginal ever since the 1950s.)

You can own almost untraceable money. You can have privacy to an extent that few Americans care about. With Craigslist, which is a used goods emporiums (discounts available for cash), with every retail outlet in the United States, you can buy what you want, when you want almost perfect privacy. But you do not do this.

So, with respect to a monetary unit that arouses no suspicion, one which has been in constant use since 1914, and which is readily available at any ATM, **the American public does not want to buy privacy money**. This is a market fact. People have made their decisions not to own privacy money. The lack of interest is a product of human action.

Bitcoins. You probably don't know how to buy Bitcoins. You have no intention of buying Bitcoins to use as an alternative form of money. I can say this in confidence, because you have no intention of buying paper money as an alternative form of money. If you will not buy paper money, which is legally equal to digital money, and which can be used in any retail establishment in the United States today, then why would you buy Bitcoins as an alternative currency that provides privacy? Why would anyone buy Bitcoins on this basis?

Think through the logic of Bitcoins as a privacy currency. What advantage do you get with Bitcoins that you do not get with greenbacks? Second, since you are not interested in using greenbacks as privacy money, what possible reason would you have for buying Bitcoins for use as privacy money? And remember: you are not normal. You have real concerns about the United States government and the Federal Reserve System. You are not a representative figure with respect to interest in a currency that will give you privacy. The average Joe has no such concerns. The average Joe will take your paper money in exchange for anything he is selling today. Also tomorrow. Also next year.

Conclusion. The conclusion is obvious. Almost nobody is buying Bitcoins to be used as private currency. They are buying Bitcoins because there is a mania going on. People are buying Bitcoins because they think other people will buy Bitcoins. It is all based on the **greater fool theory of investing**.

The official justification is that this currency provides privacy. That is the number-one reason why we can safely say that nobody is buying Bitcoins for use as private currency. Why is it safe to say this? Because anybody can buy private currency by going to an ATM, and then spend this currency in any retail establishment at any time. Nevertheless, virtually no Americans in the middle class do this on a regular basis for more than token payments, such as fast food meals. So, as people who understand economics, we can safely conclude that the selling point of Bitcoins as private money is just plain silly. It is merely a self-justifying cover for a gigantic bubble based on the greater fool theory. The greater fools are not buying Bitcoins for privacy's sake.

There is an old rule in marketing: "Never try to sell anything that people do not want to buy, which must be sold by educating them to reject their present beliefs. You cannot afford the advertixing cists to persuade them."

If Americans do not want to buy greenbacks to replace digital money, few will buy Bitcoins as an alternative to paper money, which is a widely unwanted replacement of digital money.

If large numbers of people ever decide to abandon digital bank fiat money, why will they go to Bitcoins rather than digital gold money or digital silver money, or gold coins, or silver coins? Why will people in India, China, and the Middle East buy Bitcoins? Why will they abandon millennia of tradition in preference for Bitcoins, knowing that other central banks can imitate the People's Bank of China at any time, driving down the price?

A CASE STUDY

Late-comers to a mania do things like this. It was reported in the Los Angeles Times.

NEW YORK -- Donald Duhaney brought a wallet full of cash to a Whole Foods in Manhattan's trendy Lower East Side one recent evening. But he wasn't in search of kale, quinoa or cage-free eggs.

Duhaney, 37, was in the market for bitcoins, the hot digital currency that has caught the eye of entrepreneurs and regulators. So he ventured to a pair of couches on the supermarket's second floor, next to the Jamba Juice, where enthusiasts meet weekly to buy, sell and talk bitcoins. He quickly found a seller: a quiet young man in a trench coat lounging in a green armchair. Along with a friend who trades so-called crypto currencies, the two used their iPhones to check bitcoin's going price -- then about $830 on a leading online exchange.

Then they sealed the deal. Duhaney pulled out $1,005 -- 10 crisp $100 bills, and five ones -- in exchange for 1.2 bitcoin, which was transferred via an iPhone app.

"It looks like something nice to invest in," said Duhaney, a computer programmer who lives in suburban White Plains, N.Y. "Right now, it's taking off."

He got his name in the newspapers. He had bought this with real money: greenbacks. He had privacy. Now he has less.

His investment is now worth 12% less, thanks to the People's Bank of China.

"It looks like something nice to invest in."

It surely does . . . if you love volatility. It you love being dependent on central bankers. If you don't understand what you're buying, and you have to go to Whole Foods and get help from a couple of kids to buy it.

CONCLUSIONS

If people are buying Bitcoins because of their alleged independence from central banks, they are ignorant of economics. The People's Bank of China has proven the extent to which Bitcoins are dependent on the commercial banks for their market value.

Second, paper currencies provide far better privacy.

Third, the cost of buying paper money is the cost of using an ATM.

Fourth, hardly anyone wants to use paper currencies.

Fifth, Bitcoins offer no advantage over gold or silver digital currencies.

Conclusion: **people are buying Bitcoins because of the mania**. They want to get rich quick. They will accept any seemingly plausible justification, because they do not want to admit to themselves that this is a mania, and manias always end badly for latecomers. So, they tell themselves this: "Bitcoins will be the world's future money -- not gold, not silver, and not central bank money."

What is the evidence for this faith? It is not this: privacy. It is not this: low information costs. It is not this: independence from central banks. It is not this: a long tradition of its use as money.

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Gold, Money, and Credit: The Confusion Remains.

Gary North

Sept. 24, 2009

A site member with no common sense and even less understanding of money attacked me on a forum yesterday. He called me a Friedmanite and a Keynesian on money (there is no such conceptual position). Me? A Friedmanite on money? This accusation violated a site rule: no profanity.

First, I am generally regarded as one of the academic expositors of the Austrian School's position on money. You can find my mini-book, Mises on Money, on Lew Rockwell's site. http://Lewrockwell.com/north/MOM.html

Second, it is a good idea to avoid confrontations with an expert. It is a better idea to avoid telling him that he has adopted the position of his opponent of over three decades. He has taken too many years of criticism from Fiedmanites for not adopting monetarism.

Third, one of the tricks that amateurs make is to misquote a "bad guy," attribute his position to the target/victim, and give the impression that the target/victim is a dolt. Do not try this with an expert on the topic who is a 45-year practitioner of confrontational rhetoric. You will get your head handed to you. Let me demonstrate.

Unfortunately, your reply makes it appear that you have joined Milton Friedman (banks create money) and the ranks of establishment economists in general with your statement that, "All money is credit." This is precisely the view that Keynes promoted with his publication of the

General Theory in 1936. As he said in addressing his "fellow economists", per my September 22nd posted quote of his Green Cheese metaphor, we must persuade the public that central bank credit is practically the same thing as money. Then the central bank (green cheese factory) can create it (green cheese) as necessary to reduce unemployment among workers who won't accept lower nominal wages.

This man has never read Murray Rothbard's book, The Mystery of Banking. In it, Rothbard adopts the standard textbook approach to fractional reserve banking, showing that fractional reserve banks create money. He opposed the practice, but it was at the heart of his analysis. It is at the heart of every economist's analysis. This has nothing to do with "establishment economists." To tar and feather me with that pejorative phrase shows that the critic is both uninformed in his understanding of banking and a dolt in trying this stunt with me on my site.

By the way, I owned the publishing rights to this book. I turned this over to the Mises Institute. You can get it for free here:http://mises.org/Books/mysteryofbanking.pdf

In other words, Keynes sought to actualize what is probably the oldest bankers' plea in the infamous history of banking: "Forget what I promised; forget my debt! Or as banking economist, John Exter used to say, accept my "IOU nothing" and consider that you have been paid. Or, as Elgin Groseclose more elegantly put it in an early '80s confrontation with Fed Governor Henry Wallich, "You have defaulted on your fiduciary media." (No credit instrument confusion with money is possible there.)

This is merely a series of unrelated sentences strung together. There is nothing here that relates to the question at hand, namely, my original assertion that credit is money, and that if you cannot spend credit, it isn't money.

To combat the prevailing green cheese delusion, as well as to preserve our personal wealth, we need to stick with definitions that originated in the marketplace and which were formalized in early US statutes. Miners, through sweat labor, not bankers, produce money. As Jefferson, the father of the US dollar, put it, "You must dig a dollar out of the ground." (Those tired old silver dollars we've salted away, "just in case," are exactly what Jefferson had in mind.)

This is utter nonsense. Miners do not create money. Individuals trading with each other create money. Gold or silver became money after they were used for other purposes. This is the heart of Mises' famous regression theorem. It defines the Austrian theory of money. This poor guy is completely unaware of monetary theory in general and Mises' view in particular.

Murray Rothbard expanded on Jefferson's assertion simply and succinctly when he summarized the Austrian School position on money in his booklet: "What Has Government Done to Our Money?" (P.4): "A most important truth about money now emerges from our discussion: money is a commodity. Learning this simple lesson is one of the world's most important tasks. So often have people talked about money as something much more or much less than this. Money is not an abstract unit of account, divorceable from a concrete good; it is not a useless token only good for exchanging; it is not a 'claim on society'; it is not a guarantee of a fixed price level. It is simply a commodity. It differs from other commodities in being demanded mainly as a medium of exchange."

Mises in 1912 defined money as **the most marketable commodity**. Rothbard was following Mises on the origin of money. But this is irrelevant once there are receipts for the commodity, i.e., when there are IOU's, i.e., fiduciary media. This is what the Austrians focus on.

The author then rambles on and on about what money ought to be. It ignores the obvious: money is what you buy things with. This person used to subscribe using bank digits called money. To play verbal games as if this were not money is nothing short of imbecilic. It is a deliberate attempt to mislead people. I resent it.

The tyranny of vocabulary that was a purposeful outgrowth of Keynesianism, forces us to speak of Federal Reserve Notes as if they were money proper, and to argue over various sorts of "a return to the gold standard."

Federal Reserve Notes began in 1914. Keynes wrote in 1936. What kind of word games is this guy playing? Stupid ones.

What we should be demanding is a resumption of payments on Fed greenbacks, similar to that which followed the Resumption Act a few years after the Civil War suspension of specie payments. Of course unlike the 100 cents on the greenbacks promise of a dollar that followed the 1875 Resumption Act, there would need to be a huge market-related markdown on the value of Fed notes in terms of gold dollars. (The markets have already depreciated Fed notes by about 98 cents on the original gold dollar since they were first issued in 1914. That's a depreciation of banknotes comparable in magnitude to that of the "shinplasters" issued by wildcat banks in the backwoods of 19th Century America.)

While we're at it, why not just abolish the FED? I mean, if you are proposing pipe dreams, why not go all the way? Who needs Federal Reserve Notes?

Now I suspect, and fervently hope, that you wrote a somewhat hasty reply and inadvertently left out an important qualifier to your assertion that all money is credit. The qualifier is, that government has intervened in the marketplace and decreed via a legal tender law that we must accept Federal Reserve Notes (IOU's) as if they were really the sums of money that would constitute payment.

My hasty reply was based on 45 years of study and writing. Take a look at my first nationally published article, "Domestic Inflation Versus International Solvency." That was in 1967.

The man's comment is economically irrelevant. Legal tender currency is money. I do not need a qualifier.

Certainly that wouldn't imply that we must accept Keynes' green cheese delusion and believe that FRN's really are money, any more than we'd believe that if government were to decree that laundry receipts are really clothing, we'd happily run around dressed only in paper receipts, all the while hoping it didn't rain.

Gold is not money. You cannot walk into a store and buy anything with gold. There are no bar codes with gold coins in their software. You can buy with Federal Reserve Notes. They are money.

Money has this feature: liquidity. What is liquidity?

1. You can sell the asset immediately.
2. You can sell it without offering a discount.
3. You can sell it without advertising.

I have called for the re-monetization of gold. I began this call in 1964.

Question: If gold should be re-monetized, has it been de-monetized? This idea is beyond my critic's power of comprehension.

Gold was de-monetized by Roosevelt in 1933. He made it illegal for anyone inside the United States to own gold. Why did he do this? To de-monetize gold.

On gold as not being money today, see my article on Lew Rockwell's site.

http://www.lewrockwell.com/north/north196.html

No doubt my critic would accuse Rockwell and the Mises Institute of being Friedmanite Keynesians on money, whatever that might be.

I suggest that you do your bit to re-monetize gold. Buy some gold coins.

A reminder: Don't treat me or anyone else as an ignoramus on my forums. I police this site. I will boot off anyone who does this, just as I booted off this man. He will get back his $14.95.

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The Meaning of Revaluation in an Era of Digital Currency
Gary North

May 9, 2009

The terms "devalue" and "revalue" were appropriate in the era of fixed exchange rates between national currencies. Unofficially, that era ended on August 15, 1971, when Nixon closed the gold window and floated the dollar. By 1976, all major currencies were floating.

A devaluation prior to 1971 was made by a central bank. It announced that the nation's currency would no longer trade at the existing fixed rate, but rather at a lower rate. All those who had moved their currency accounts out of the domestic currency and into the foreign currency won. They wound up with more foreign currency than they could get under the new regime. They could trade back for more units of the domestic currency.

Conversely, a revaluation is what happens on the other side of the border. A foreign central bank announces that it will raise the price of its currency, as denominated in a foreign currency. This devalues the other currency and revalues the domestic currency.

These overnight devaluations and revaluations take place because the true conditions of supply and demand are different from the price controlled currency system. The de-valuating nation finds a rush out of the domestic currency. Its holdings of a foreign currency are depleted, as foreign central banks exchange the officially overvalued national currency for the officially undervalued domestic currency. The devaluation is an admission of failure by the devaluing central bank. "We were wrong. Our currency really isn't worth what we said."

In late 1923, the German government revalued the mark by issuing a new currency with only a few zeroes. This was an admission of guilt and also a way to regain favor with Germans. It worked. The new currency circulated immediately. The same thing happened in 1948, when finance minister Ludwig Erhard knocked off a zero from the fiat marks, and also abolished all price and wage controls. The new currency was immediately successful. These were acts of revaluation. They raised the value of the domestic currency by abandoning the old currency.

If a new government knocked off zeroes from Zimbabwe's currency, and the central bank ceased printing money, the new currency would circulate. It would be trusted far more than the current currency is trusted, which is not at all. Some trust is better than no trust.

A revaluation is rare. It comes after a time of high inflation. It is a desperation move. It is an admission of failure. But it is usually believed when central bank policy moves to zero inflation.

If a central bank ceases to inflate, the recession will hit. If it sticks to its guns, the recession becomes a depression. Prices fall. This is a revaluation of the currency unit. It is the basis of long-term recovery. It has not happened anywhere in the West ever since the West went off a gold coin standard. Central banks never stick to stable money policies.

Appendix

Is Bitcoin Money?: What Economists Have To Say

As a follow up to [my report that Hans Hermann Hoppe does not believe Bitcoin is money](), EPJ reached out to a number of economists and others familiar with Bitcoin, to get their view on whether Bitcoin is money. We asked all to simply answer "yes" or "no", or to provide a short paragraph on Bitcoin. These are the responses we received (Note: All responses were provided before the shutdown of Silk Road):

William Anderson: I say "yes" because Bitcoins are accepted as payment for goods and it also operates as a parallel currency in some countries, such as Argentina. A monetary form does not have to be accepted by a government or officially labeled as "legal tender" in order to become money. Money is a good that facilitates indirect exchange, and Bitcoin fits that profile.

Walter Block: Bitcoin is not (yet) money. Money is properly defined as something generally used to facilitate trade, as an intermediary, so that we do not have to engage in barter. Most restaurants, supermarkets, movies, shoe stores, airlines, car dealerships, drug dealers, massage parlors, doctors, lawyers, accountants, etc., will not accept bitcoins for payments for their goods and services. When and if bitcoin is generally accepted for such purposes, it will then become a money.

David Gordon: I don't think that Bitcoin at the present time is money, as it is not now in use as a general medium of exchange. If enough people were to use it in transactions, it could become money.

Guido Hülsmann: Money is a generally accepted medium of exchange. While it is obvious that bitcoins are media of exchange, it is not quite clear whether they are also money. Are they generally accepted? I don’t think that this is presently the case. Most people are not even aware that bitcoins exist, and most of those who have heard of them do not at present consider using them. Things could change, especially if price-inflation rates pick up, but at present we are not yet there.

Trace Mayer: Yes. Bitcoin is money because it is limited in amount by internal characteristics enforced by the laws of mathematics and thermodynamics that is not subject to counter-party risk or anyone's liability and it also functions as a currency because it acts as a medium of exchange.

Pippa Malmgren: The answer is "Yes". Money becomes real when people have faith in it. Governments have no monopoly on that which is why they spend a lot of time putting many symbols of faith and trust on the currency from pictures of sovereigns like the Queen or the President to hidden symbols of power like pyramids and seals. They would not need to if it stood on its own. Faith can be earned and it can be lost. The problem with bitcoin is that people are afraid a power outage or a hacker or bad management could erode or destroy the value of a bit coin. But, then again, governments are doing their best to erode confidence in fiat money too.

Robert P. Murphy: Not yet.

George Reisman: No. Bitcoin is not money. The essential characteristic of money is that it is a generally accepted medium of exchange. Everyone is glad to accept money in exchange for his goods or services. In contrast, only a handful of people are presently willing to accept Bitcoins in exchange, i.e., the handful of people willing to buy bitcoins.

In order for bitcoins to someday become money, a reliable exchange value would have to come into existence for them. This could be achieved if some important country became willing to redeem bitcoins on demand in exchange for its own currency, and do so for some time, or provide a sufficient fund of its own currency to make this possible by others. In that case the money character of that currency mighty be transferred to bitcoins, Such a process took place in 1924, when a new German Mark was introduced on a foundation of dollars and gold, following the destruction of the previous Mark in the hyperinflation of 1923. Perhaps today, if Bill Gates and Warren Buffet, say, combined their resources to support the value of bitcoins for a few years, a similar result might be achieved, but even that is doubtful, because even their resources are probably not sufficient, and, of course, they would have no possible motive to do this.

Otherwise, a process would have to take place similar to that which enabled gold and silver to emerge as money, namely, first, the existence of an exchange value based on use as a commodity, and then an additional and wider exchange value based on use as a store of exchange value. When enough people wanted to acquire gold or silver as a store of value, even those not interested in doing so, became willing to accept gold or silver because they knew that a substantial number of people were ready to accept it from them.

Lew Rockwell: I love Bitcoin. It's a wonderfully creative business. But obviously, it is not the most liquid good in society. Could it ever become money in this fiat world? One cannot rule it out.

Scott Sumner: I would say “no” or at least “not yet.” The most important aspect of money is its role as the medium of account, or numeraire. As long as most wages and prices are denominated in dollars rather than bitcoins, then it is not money. Bitcoins will be money if and when the CPI is reported in terms of bitcoin prices.

Mark Thornton: Bit coin is a medium of exchange and a payment system. It has some economic advantages over government fiat money but at this time it is not money--a generally accepted medium of exchange.

Lawrence H. White: Using the standard criterion for moneyness, to ask whether Bitcoin is money is to ask whether it is a commonly accepted medium of exchange. A medium of exchange (MOE) is a good that is the intermediate link in a transaction chain, a good acquired in one trade for the purpose of being traded away later for something else. Bitcoin is clearly not a commonly accepted MOE in the US economy as a whole, but no doubt some individuals or businesses do use Bitcoin balances as MOE, treating it like ordinary currency or checking account balances. They sell goods or services for Bitcoins, hold the Bitcoins, and later spend them to buy other goods and services. If Bitcoin is commonly accepted as a medium of exchange within a circle of such users, it is money in that circle. But note that nobody, as far as I know, receives their income or buys most of what they consume in Bitcoin. It is not the primary money for many, perhaps not any, of its users.

How big is the circle of Bitcoin MOE users? It would be interesting to know. Annual transaction volume in Bitcoin, at $30 million per day, exceeds the annual purchases of newly produced goods and services (GDP) in Surinamese dollars, to choose one minor money. But not all Bitcoin transactions represent purchases of goods and services, and thus not all use is monetary use. I suspect that purchases of goods and services are only a small fraction of Bitcoin transaction volume, but I don't know how to figure the percentage. (Perhaps someone else can decipher the data available at blockchain.info, or find relevant other data, better than I can.) When John Doe buys Bitcoins with dollars in order to speculate against dollars, and expects to later sell his Bitcoin holdings for dollars, he is not using those Bitcoins as money. When a business sells goods for Bitcoins, then exchanges those Bitcoins at the end of the day for US dollars, it is using Bitcoins only very briefly as money.

Tom Woods: Bitcoin is a medium of exchange but not money. This isn't an insult to or a value judgment about Bitcoin. Austrians sometimes describe money as the most widely accepted medium of exchange in society. Clearly Bitcoin does not satisfy this requirement.

Mises, for his part, describes money as a medium of exchange in common use: "A medium of exchange which is commonly used as such is called money. The notion of money is vague, as its definition refers to the vague term 'commonly used.' There are borderline cases in which it cannot decided whether a medium of exchange is or is not 'commonly' used and should be called money."

I don't think Bitcoin is in common enough use to be called money.

We did reach out to a number of other economists who did not respond. Paul Volcker, Ben Bernanke and Janet Yellen were among the non-responders.

Alan Greenspan's assistant sent this email reply:

Thanks for your inquiry. Dr. Greenspan's schedule is heavily committed and he's unable to respond to your question.

Bitcoin and Gold: Currency versus Money

1
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by John Rubino on February 10, 2014 · 13 comments

Bitcoin holders — especially those who bought in during the crypto-currency's recent surge past $1,000 — are a bit shell-shocked this week:

Bitcoin prices plunge as problems persist

Bitcoin prices plunged again Monday morning after Mt.Gox, the major exchange for the virtual currency, said technical problems require it to continue its ban on customer withdrawals.

Mt.Gox said it has discovered a bug that causes problems when customers try to use their account to make a transfer or payment of bitcoins to a third party. It said the problem is not with Mt.Gox software but affects all transfers of bitcoins to third parties.

The exchange said it was suspending withdrawals and third-party payments until the problem is fixed, although trading in bitcoins continues.

A bug is allowing a third party receiving a bitcoin transfer to make it look as if the transfer did not go through, which can lead to improper multiple transfers, Mt.Gox said.

Bitcoin prices on Mt.Gox plunged from about $693 just early Monday to $510 at 6 a.m. ET, soon after the statement was posted. Prices had been as high as $831 just after 7 p.m. Thursday before Mt.Gox's halt of withdrawals was first disclosed early Friday morning.

Mt.Gox tried to put the best face on the technical problems in its latest statement, noting that the technology is "very much in its early stages."

"What Mt.Gox and the Bitcoin community have experienced in the past year has been an incredible and exciting challenge, and there is still much to do to further improve," it said.

This is one of those "teaching moments" that the President likes to point out. But the lesson isn't that bitcoin in particular or crypto-currencies in general are fatally flawed. It is that they are currencies, not money or investments, and the differences between these three concepts is crucial to doing asset management right.

An investment is something that, if successful, generates cash flow and potentially capital gains, but if less successful can produce a capital loss. Money, in contrast, *is* capital. It is what you receive when you sell an investment and/or where you store the resulting wealth until you decide to buy something with it. Money does not generate cash flow and does not "work" for you the way an investment does. Instead, it preserves your capital in a stable form for later use.

"Sound" money exists in limited quantity and doesn't have counterparty risk – that is, its value doesn't depend on someone else keeping a promise – so it tends to hold its value over long periods of time. Gold and silver, for instance, have functioned as sound money for thousands of years. As you've no doubt heard many times, the same ounce of gold that bought a toga in ancient Rome will buy a nice suit today. Ditto for oil, wheat and most of life's other necessities.

Currency, meanwhile, is the thing we use for buying and selling. It can also be money, as in past societies where gold and silver coins circulated. But it doesn't have to be. Paper dollars, euro, and yen are representations of wealth rather than wealth itself and are only valuable because we trust the governments managing them to control their supply and banks to give us back our deposits on demand. Such currencies are not very safe but are extremely convenient, so even people who understand the inherent flaws of today's currencies keep some around for transacting.

As for bitcoin, for a while the more excitable in the techie community seemed to think that crypto-currencies could function not just as currency but as money, i.e., as a form of savings, because the supply of bitcoin was limited by the algorithm that creates it. But they were overlooking counterparty risk. Since the vast majority of bitcoins in circulation are stored electronically and transmitted over the Internet, they're only valuable if those media function correctly. Let a system fail, as Mt. Gox apparently has, and the bitcoins in that system are either unavailable (in which case their immediate value is zero) or suddenly very risky, in which case they're obviously not a good savings vehicle.

Is this a deal-breaker for crypto-currencies? No. In many ways bitcoin is a better currency than the dollar because it can't be inflated away by a desperate government or confiscated in the coming wave of bank bail-ins.

People who understand crypto-currencies and own a small amount of bitcoin for transactional purposes are probably unfazed by the latest speed bump. And people who had their life savings in it have received a valuable lesson in the nature of money.

Tagged as: bank bail-in, Bitcoin, Dollar, euro, fiat currency, gold, inflation, Mt. Gox, silver, sound money,yen

Bitcoin: Revolution or Trap? Part 2

6

inShare

by John Rubino on February 5, 2014 · 16 comments

Adapted from Chapter 18 of ***The Money Bubble*** by James Turk and John Rubino:

In 1999 a brilliant, erratic iconoclast named Shawn Parker aimed an arrow at the heart of the recording industry. Called Napster, it allowed owners of music to swap it with others online, from one hard drive to another – without paying for it. The recording industry sued, and Napster went bankrupt. But the genie was out of the bottle and file sharing services have since proliferated, changing the world of digital media forever.

If a similar technology were to have the same impact on finance, the implications would be profound. By allowing anonymous person-to-person (P2P) transfers of *money* with no national origin, a crypto-currency like Bitcoin could shift the global financial system beyond the control of the world's central banks, something just as scary to them as the unlimited sharing of music was to the record labels.

By late 2013 the world's governments were wondering whether to try to co-opt Bitcoin or destroy it. The New York Department of Financial Services began questioning businesses that accept Bitcoins about their anti-money laundering safeguards. The U.S. Senate Homeland Security and Government Affairs Committee began an investigation into who should regulate virtual currencies, and how they should do it. And Germany's finance ministry announced that the country would recognize Bitcoins and other digital currencies as "private money" and start taxing their capital gains.

Here in early 2014 it is not clear that regulating and/or taxing a crypto-currency is even possible. Attempts to shut down other kinds of file sharing (though not individual file sharing sites) have failed, and the "darknet" market for drugs, stolen property and even murder-for-hire is surviving in the face of official disapproval.

So the questions become: Are national currencies about to go the way of the $16 music CD? Is Bitcoin the agent of this change? Or is it a bleeding-edge pioneer like Napster, opening doors through which others will walk?

Or Is It A trap?

What if, instead of threatening the powers that be, crypto-currencies like Bitcoin and its eventual competitors play into the hands of the emerging police state by giving them even greater control over our financial lives? Catherine Austin Fitts, author and proprietor of the**Solari Report** website examined the dark side of online money in a recent **interview** with GoldMoney's Andy Duncan:

"There's nothing the top people driving and managing the financial system would love more than a digital currency. Nicholas Negroponte used to run MIT's Media Lab and said that 'in a digital age, data about money is worth more than money.' If you can ultimately merge digital currencies [into one global currency] the people who control the digital systems and the Internet will have far more centralized power. Their access to real-time data on what we're all doing will be fantastic and amazing. So clearly if your goal is centralized governance of financial systems, you love digital money that is anonymous to the user, where you don't have to put sovereign insurance behind it, but completely transparent to you.

If I take money out of my bank, I take it from a place where they know me, where I have FDIC insurance and paper verification, where I don't have to depend on digital systems because I have paper as well as digital records. If I move it out of that structure where there is risk management and trust, go into something that is completely anonymous, I give up a lot.

The people running the financial system are great at letting things emerge and prototype and develop the knowledge you need to scale it up and then take it over. The more we depend on purely digital systems that have no tangible backing, the more we're going to encourage the kind of global digital currency that's centrally controlled and puts us in harm's way."

Another disturbing angle involves the growing cyber-war capabilities of the US and other major nations. In the aggregate they are throwing tens of billions of dollars each year at developing the tools to hack virtually any system. If they gain access to the algorithm that governs the increase in the supply of a given crypto-currency – or figure out how to intercept transactions en route from buyer to seller – they would be able to hijack that currency for their own ends, either to finance themselves or punish/control those who depend on it. As Catherine Austin Fitts says, "Anybody who thinks the government can't control crypto-currencies is just dreaming."

This lack of physical reality ultimately means that crypto-currencies can't, in our opinion, be considered "money." That is, they function beautifully as a currency, but as a store of value they are suspect because they lack a corporeal existence. So they're not an appropriate place for one's life savings.

But don't count them out. Given the speed with which other Internet applications – and the Internet itself – have evolved from techie playthings to essential tools of modern life, it's easy to envision crypto-currencies traveling the same path. They have the potential, once their kinks are ironed out, to function as an efficient online currency in a gold-based monetary system that would bypass and make irrelevant today's national fiat currencies.

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Tagged as: Bitcoin, crypto-currency, cyber-currency, deflation, Dollar, euro, inflation, money laundering,police state, yen

SPOOs vs. the Fed = No Contest

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After not publishing a Rap for the last six sessions, I thought I might take the opportunity to catch people up on my current financial market roadmap. My opinion has been that we have a bit of a game of chicken going on between the stock market bulls and the Fed. The bulls believe that the SPOOs have been climbing higher because the market is correctly (in their eyes) anticipating a self-sustaining recovery, with job creation and all sorts of other fantasy outcomes. The counter view, which I hold, is that the only reason the SPOOs have reached 1,850 is because the Fed printed a trillion dollars last year, which means there is absolutely no way on earth that the Fed can taper and have the stock market stay anywhere near where it has been. Thus, my expectation has been at some point the stock market would find a reason to decline and eventually would get thumped enough that the Fed would have to taper its tapering.

An App-surd Idea Obviously, the FOMC is not just focused on the stock market, it is focused on the economy, too, but that has been getting weaker, though it has gotten a pass due to the weather. Friday's leap in the S&P while the high-flyers were getting cracked was more likely a function of month-end tape painting than anything else. (The level of insanity ratcheted up to 1999 levels just before I left, as Facebook decided to pay $21 per eyeball -- I mean "users," as they are called in today's parlance, and for which we now pay twice as much -- for WhatsApp.) This sort of abject insanity could continue indefinitely, though now that the stock market has decided it cares about the Ukraine, maybe we have seen the insanity peak.

There is no shortage of problems here and elsewhere in the world, and should the tape start to slide there are liable to be plenty of reasons for said slide to intensify. The bottom line I believe is that at some point Fed tapering will be interrupted by stock market/economic weakness. The rally that comes from the Fed backing off its tapering could likely be a failing rally, which will be potentially interesting from a short-selling standpoint, not to mention that it will be bullish for gold (more about that below).

Turning to today's action, the S&P was about 1.5% weaker overnight. Those losses were trimmed in the early going and the indices were about 0.75% lower all session (and they chopped around that level, with the Dow a bit worse). Away from stocks, green paper was mixed, fixed income was slightly higher, oil ratcheted up a couple of percent to $105, and the metals caught a bid, with gold gaining 2% to silver's 1%.

Neither Bears, nor Paper Tigers, Can Change Their Stripes A lot of people seem to think that gold popped because of "war news," but you can hardly call what is going on in the Crimea a war. Quite simply, Putin is doing what he pleases, which is what he usually does because there is essentially no one who is willing to stop him. The EU is a paper tiger, as are Obama and Kerry. I thought the Lord of the Dark Matter said it quite well in his research note from today:

"When a weak president keeps talking nebulously about red lines and consequences, then allowing people to cross them without consequences, strong leaders -- no matter how odious and distasteful they appear to us -- like Putin are always going to take advantage of his weakness."

This is not a political comment, it is just a fact. The conflict in the Ukraine is liable to be with us for some time, because there is no way Putin is going to back off. He is going to do exactly what he wants, which is most likely take the Crimea and pull Ukraine back into his orbit. That process will be messy and produce headlines that people don't like in various markets.

Positions in stocks mentioned: