

On Bitcoin

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The key characteristics that define a medium as suitable for currency are well established and include: (1) acceptance as a means of exchange; (2) reliability as a store of value; (3) durability; (4) divisibility; (5) portability; (6) fungibility/uniformity; and (7) limited availability/supply.

Throughout history various forms of currency have come and gone, with some having performed better than others, but each successive form's acceptance has been predicated on the ways it improved upon the traits of its predecessor. For example, grain was a better currency than livestock for its portability, divisibility and uniformity. Precious metals like gold and silver were better currencies than grain for their durability, uniformity and limited availability. Resource-backed (i.e. gold standard) paper currency proved superior to gold and silver for its divisibility and portability, and fiat paper currency has proven superior to gold-backed paper currency because it resolves issues such as uneven distribution of world gold deposits (i.e. wealth, scarce resources, and purchasing power disparity), limits on growth/productivity, limits on use of monetary policy as an economic tool, international trade settlements, and short-term price instability. Although a fiat currency is not backed by gold, it is effectively backed by productive output (GDP) and derives its value therefrom, in both an absolute sense and relative to the GDPs backing other fiat currencies.

Bitcoin is an aspiring new currency. It is an encrypted digital currency; no physical form exists. Bitcoins were allegedly created by a computer programmer named Satoshi Nakamoto, not by a central government, and supposedly there is a finite global supply of roughly 21 million. Mr. Nakamoto, whoever s/he is, and other bitcoin believers envision a single currency world devoid of systemic frictions (e.g. exchange rates, transaction costs, theft, counterfeiting/fraud), monetary policy manipulation (i.e. controlling supply, demand and credit), and fiscal policy manipulation (i.e. wealth redistribution). It is an idealistic experiment testing the notion of a one-currency world.

To obtain a bitcoin requires solving complex mathematical problems using a powerful computer connected to the Internet, a process referred to as "mining". No real work or productive output from which another person could derive benefit is required. No need to toil in a dark mine shaft or fend off mosquitoes while panning in the middle of some river. However, real money is needed -- for computer equipment, physical space, an Internet connection, and excessive amounts

of electricity to cool and operate the equipment. Aside from the absence of physical labor and physical form, how are bitcoins any different (better) than gold?

They're not. Bitcoins have transaction costs (i.e. computer, Internet connection, electricity, etc.) and "mining" for them requires means currently accessible to less than 5% of the world's population, exacerbating the world's increasingly disparate distribution of limited resources and wealth. Bitcoins limit growth and productivity. They can be electronically stolen, and possibly even electronically counterfeited, although most people would never be able to tell. Like any currency, bitcoins can be subject to monetary and fiscal policy manipulation, and they do not eliminate the economic need for a flexible global credit market. Not only are bitcoins no better than gold, but they also provide no measurable improvement over fiat paper currency.

Moreover, bitcoins will likely forever struggle with the "being trusted as a store of value" trait because they're virtual – you will never physically see one unless some politically neutral global entity is formed and then decides to create one. Philosophically, psychologically and theologically speaking, the human race finds it challenging to believe in things it cannot see, not ideas so much, but things that are designed for commerce. At least with gold and paper currency, people have been able to slowly embrace today's duality because the physical forms preceded the virtual ones, and anyone at just about any time can convert their virtual currency into physical currency when they're feeling skittish. In my view, bitcoins are at best a fad, and at worst a currency reversion. While having a single global currency is a laudable theoretical goal for many reasons, it is far from a practicality today. Bitcoins are unlikely to achieve this goal, and I advise you to avoid them. If, for whatever reason, you believe doomsday is nigh and the pitfalls of fiat currency are of grave concern, you would be better off owning tangible assets like diamonds or gold.