Bitcoin lacks a solid foundation as an international currency

Financial Times June 7, 2021

The value of bitcoin and other cryptocurrencies has multiplied in the last decade. Non-existent returns on fixed-income securities and the fear of future inflation when central banks let the money printing press run at full tilt have led investors to seek alternatives. Many have invested in cryptocurrencies. There is also a superstition that they will take over as an international means of payment. El Salvador's president recently said he would make bitcoin legal tender in the country.

Research has shown that an international currency must meet at least four basic conditions: it must have a long-term stable value; there must be sufficient volume to meet the needs of international trade in goods, services and financial assets; transaction costs must be low, with small differences between bid and ask prices, and high liquidity; and there must be a stable issuer who guarantees the currency.

Based on this, market participants choose which currency should be the most viable in world trade, and no supranational authority is needed. The conditions apply for both commodity and fiat money. For fiat, there must be an issuer, as the currency implies a commitment to the holder.

Historically, all dominating international currencies met the requirements: Athenian tetradrachms (c. 480-40BC), Roman denarii (211BC-AD2oo), Byzantine solidus (300-1085), florins and ducats from Florence and Venice (1250-1600), the Dutch guilder/ducat (16Q_Q:178o), British pounds (1800-1918) and finally US dollars (1918-present). Of these, the gold coin solidus was the longest-lived, its content and weight unchanged for more than 700 years, giving rise to the word solid.

Bitcoin, however, meets none of the four conditions. First, it has greater volatility than any other predominant currency in history. Price changes of tens of per cent within days are commonplace. Second, there is a pre-determined maximum amount that can be created. If it is to cover the needs of a growing international trade, the relative value of the currency must increase, which makes it even more unstable. Third, transaction costs are high; transactions take time and the system can only handle a limited number per time period.

Furthermore, the blockchain system that produces bitcoin consumes enormous amounts of energy and there is no stable issuer that can guarantee the currency. If one or more large regimes were to ban transactions, the fairy tale could soon be over. And while the limited amount of each cryptocurrency restricts over-issuing, there are a huge number of them, with new ones created every day.

A medium that works well as money should reduce transaction costs but must also act as a store of value. Money can then act as a lubricant in the economy. Bitcoin cannot fulfil these functions either. Money has the character of a network product: the more people who accept it, the more worthwhile it becomes. Bitcoin is only accepted within a limited group.

The popularity of cryptocurrencies is partly due to the anonymity of holders of bitcoin wallets. Although transactions can be identified, it is difficult for third parties to identify who is behind them. This makes them popular with criminals and money launderers. Others see them as a possible investment. But there is nothing value-stable in a medium that does not meet any function as a mode of exchange, unit of account or store of value, and which lacks an issuer. The increase in value is reminiscent of a pyramid scheme where investors constantly hope that others will value the asset ever higher.

When bitcoin regains its true value, the awakening could be brutal for many. It is not only the cryptocurrency that has a limited volume, but also the number of people who are tempted to join pyramid schemes.

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