

# Political Econ and Cryptocurrencies



Many economists believe the 2008 global recession was the worst financial crisis since the Great Depression in the 1930s. The problems began in 2007 after a number of US banks went bankrupt after aggressively issuing loans that could not be repaid.

This escalated into a worldwide economic downturn that saw the crash of the Lehman Brothers and the onset of the European debt crisis, which left many countries on the brink of bankruptcy. The climate of political chaos and turmoil only served to increase the appetite for financial alternatives to the status quo.

In 2009, Satoshi Nakamoto released Bitcoin as a hedge against future financial crises. The first block mined on the Bitcoin blockchain was known as the 'genesis block', which included the text: "The Times 03/Jan/2009 Chancellor on brink of second bailout for banks."

This is a strong indicator that the financial crisis was the trigger for the creation of Bitcoin. In this article, we will delve deeper into the government responses to cryptocurrencies and assess whether these tokens really are a viable alternative to our current financial system.

## Measuring Monetary Value

When money developed as a medium exchange, people chose commodities such as food, gold or raw materials to trade because of their intrinsic value. However, as societies became more sophisticated, money evolved into the formal and abstract form of exchange that we now know as fiat currency.

As economies became extremely complex and centralized, the value of fiat currencies was determined and controlled by governments. This meant that communities lost control over what was widely accepted as a means of exchange, and trade became subject to profit seizure and regulations.

While fiat currencies allowed for financial innovation, growth and increased spending, the debt crisis coupled with financial mismanagement has, in the minds of many people, left an economic void that could potentially be filled with cryptocurrencies.

According to entrepreneur and MegaUpload creator Kim Dotcom, it is only a matter of time before cryptocurrencies such as Bitcoin achieve mass adoption. He said: "Bitcoin is a very exciting development, it might lead to a world currency. I think over the next decade it will grow to become one of the most important ways to pay for things and transfer assets."

Ben Shalom Bernanke, an American economist at the Brookings Institution who served two terms as the chairman of the Federal Reserve, was equally as optimistic. He stated: "Virtual currencies may hold long-term promise, particularly if the innovations promote a faster, more secure and more efficient payment system."

## Political Appetites For Cryptocurrency

Some countries have already incorporated cryptocurrencies into their economy.

### Asia

The Japanese government set up a framework that makes it legal to use cryptocurrencies for payment purposes, through the PSA (Payment Services Act). In addition, a number of cryptocurrency exchanges were approved by the FSA, which is the financial regulatory arm of the Japanese government.

This is in sharp contrast to the way governments in China and South Korea have responded to cryptocurrencies. Both countries have taken drastic measures against digital tokens such as Bitcoin.

The Chinese government has issued an outright ban on virtual currencies, while South Korea has banned initial coin offerings and shut down many local cryptocurrency exchanges.

## Europe

In contrast, many governments in Europe have been much more favourable in their response to cryptocurrencies. In Germany, Bitcoin is actually recognized as a legal currency.

Holland has taken this a step further and introduced a 'Bitcoin City', which is where hundreds of cryptocurrency merchants and members of the public are able to make retail purchases at shops and cafes with Bitcoin.

## Africa

Several countries in Africa have also quietly embraced cryptocurrencies and blockchain technology.

In Kenya, blockchain technology has already been deployed to "enable credit scoring of small businesses," while in 2017, South Africa launched its first governmental cryptocurrency startup, Project UBU. In Uganda, the Ministry of ICT said the government will leverage blockchain technology to improve efficiency in public services.

Mr Vicente Bagiire Waiswa, the Ugandan ICT Ministry permanent secretary was quoted as saying: "Government is going to use blockchain technology where it is appropriate to provide seamless services to the general public."

He added that it was time Uganda adopted the technology for economic inclusion. Central banks and government officials in other African countries such as Nigeria and Rwanda have also commissioned research into the impact of cryptocurrencies on their local economies.

## Economic Benefits of Cryptocurrencies



The US dollar is at the helm of the global economy and many countries are dependent on it, as it is the reserve currency of the world. This is one of the reasons why a financial crisis in the US has such a devastating impact on the rest of the world.

The 2008 global downturn is a pertinent example of that. However, cryptocurrencies such as Bitcoin, Ethereum, Ripple and other virtual currencies may be the key to changing the financial landscape and reducing the interdependence on fiat currencies such as the dollar.

Part of their appeal is that they help to reduce the need for large financial institutions and authorities to authenticate and authorize transactions. Instead, they are predicated on smart contracts, which facilitate the exchange of valuable assets and make it possible for commercial transactions and agreements to be conducted automatically, because the smart contract enforces the obligations of all involved parties.

This can effectively speed up the process of verifying transactions, lower costs and increase security. Blockchain technology has also led to the proliferation of multiple startups that are actively developing projects which incorporate cryptocurrencies into their operations.

Traditional companies, which include anything from healthcare giants to banks are also increasingly integrating blockchain technology and crypto assets into their business models. Indeed, this has fed into the optimism about the future of cryptocurrencies.

Consider the following quote by Wall Street Journal reporter Paul Vigna: “The blockchain keeps everyone honest, and a whole layer of banking bureaucracy is removed, lowering costs.”

Edmund C. Moy, an American businessman and former government official said: “Bitcoin, and the ideas behind it, will be a disruptor to the traditional notions of currency. In the end, currency will be better for it.”

## Cryptocurrencies - Obstacles to Mass Adoption

When the combined benefits of cryptocurrencies are taken into consideration, it is little wonder that many leading experts believe that the mass adoption of cryptocurrencies is inevitable. However, digital currencies also come with their own set of problems. The volatility of cryptocurrencies such as Bitcoin and Ethereum is one of the biggest obstacles to mainstream adoption.

For example, nobody would buy their groceries with Bitcoin if they thought that its value would increase exponentially in just a few months. Furthermore, the inherent risks in these crypto assets would dissuade many institutional investors because the fundamentals in the market would be too weak to warrant significant capital allocation.

For example, John Rainey CFO of PayPal, said in an interview with CNBC’s ‘Mad Money’ that merchants who use the payment platform have traditionally been reluctant to accept cryptocurrency transactions due to the risks they pose.

He said: “If you're a merchant and you have, let's say, a 10 per cent margin on a product that you sell and you accept Bitcoin, for example, and the very next day it moves 15 per cent, you're now underwater on that transaction.”

So while there is clearly an appetite for cryptocurrencies, it is unclear how the volatility of these tokens would impact the financial landscape of countries around the world.

The other issue is that the intrinsic value of cryptocurrencies is difficult to measure. While the value of fiat currencies is determined by the government, many cryptocurrencies are uncollateralized, which means that they are not backed by commodities or traditional currency. Instead, the value is in most cases, determined by sophisticated algorithms and the expectation that they will maintain their value.

However, new innovations are occurring all the time in the world of cryptography and other tokens such as stablecoins are backed by crypto assets, fiat currency and commodities. These tokens, as the name suggests, retain a certain level of stability. However, the complex nature of some stablecoins means that only the most experienced investors with extensive knowledge of blockchain technology will be able to benefit from them.

Over-regulation and an uncertain legal environment are also major issues in the world of cryptocurrency. In Ecuador for example, the National Assembly has issued a ban on Bitcoin and

other decentralized currencies due to the establishment of a new state-run electronic money system.

The Chinese government is also reportedly working on creating its own cryptocurrency. These attempts at centralizing digital currencies may potentially override any benefits afforded by traditional, decentralized blockchain tokens.

## Conclusion

Cryptocurrencies have led to a renaissance in this new economic environment and have given a new ray of hope to thousands of investors, institutions and even governments who are looking for alternatives to the current financial system. Certainly, the benefits of these tokens cannot be denied.

The transparency and security of blockchain technology coupled with decentralization provide a fertile breeding ground for new innovations and financial independence on a mass scale.

However, the volatility and unpredictability of many blockchain tokens will do little to abate the scepticism from some of cryptocurrencies biggest critics. Consider the following quote from Warren Buffet: "In terms of cryptocurrencies, generally, I can say almost with certainty that they will come to a bad ending."

If the intrinsic value of cryptocurrencies such as Bitcoin or Litecoin is complex or inherently difficult to measure, then this will feed into the perception of crypto coins being purely speculative investments. The only way to achieve the dominance of these tokens is through mass adoption and educating society about the benefits of cryptocurrencies on our economy.

Whether such a vision will be realized remains to be seen. Yet the burgeoning power of the blockchain industry coupled with the willingness of many Western institutions and governments to facilitate the selling and trade of these digital tokens is a sure sign that cryptocurrencies are here to stay.