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Bitcoin: Revolutionary Monetary Game-Changer Or Financial Trojan Horse?

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Bitcoin Is Going Mainstream

Reddit, Virgin Galactic, and Overstock.com now accept Bitcoin.

So do dating site OKCupid and travel site CheapAir.com. Game giant Zynga is now in the testing phase.

Two big Las Vegas hotels accept Bitcoin.

Congressman Steve Stockman (R-Texas) accepts Bitcoin for 2014 campaign contributions. As does a law firm in Australia.

Reuters notes:

> Already, 21,000 merchants are using Coinbase to accept Bitcoin from customers.

Indeed, there are websites listing scores of businesses which now accept bitcoin.

(And you can use Bitcoin at Amazon, Barnes and Noble, Crate & Barrel, Target, Sears, CVS, Hyatt Hotels, Kohl's, Burger King, Applebees, Victoria's Secret, Land's End, Facebook, Groupon, Banana Republic, the Gap, AMC and Fandango movie theaters, Whole Foods, Wine.com, Wine Enthusiast, Papa John's, Nike, Adidas, Sephora, Sports Authority, Staples, Zales jewelry, Game Stop, FTD flowers, Zappos and hundreds of other stores if you use Bitcoin to buy gift cards at Gyft.)

But is Bitcoin going mainstream a good thing or a bad thing?

People Power … Challenging the Status Quo?

Andy Haldane – Executive Director for Financial Stability at the Bank of England – believes that peer-to-peer internet technology will lead to the break up of the big banks.

Bank of America said "We believe Bitcoin could become a major means of payment for e-commerce and may emerge as a serious competitor to traditional money-transfer providers"

Visa has attacked Bitcoin as being less trustworthy than its well-established payment system.

So it sounds like Bitcoin is shaking up the status quo …

Backed by … the Big Banks?

On the other hand, a lot of major mainstream players are backing Bitcoin and other digital payment systems.

Wells Fargo wants to get into Bitcoin in a big way.

JP Morgan Chase has filed a patent for a Bitcoin-like payment system. And Russia's largest bank is working on a Bitcoin alternative as well.

Ben Bernanke and the Department of Justice have both cautiously blessed Bitcoin.

François R. Velde, senior economist at the Federal Reserve in Bank of Chicago, labeled it as "an elegant solution to the problem of creating a digital currency." John Browne theorizes:

> While crypto-currencies remain insulated from central bank manipulation, governments have thus far been tolerant, perhaps because their capability to track transactions is more advanced than Bitcoin believers admit.

Indeed, Bitcoin is not really that anonymous, as the NSA can track Bitcoin trades.

The NSA can apparently also hack Bitcoin. And see this. Given that the NSA may be changing the amount in people's accounts, it would be child's play for them to change the amount in your Bitcoin wallet.

And Yves Smith argues that Bitcoin actually plays into the hands of the central bankers:

> Many [Bitcoin enthusiasts] clearly relish the idea of launching a currency outside the control of central banks (plus this beats Cryptonomicon in geekery).
>
> If you believe the hype, you've been had. As Izabella Kaminska of the Financial Times tells us, you all are really just doing free/underpaid R&D for central banks, since you are debugging and building legitimacy for one of their fond projects, making currencies digital and getting rid of cash altogether.
>
> I had wondered about the complacency of Fed and SEC officials in Senate Banking Committee hearings on Bitcoin last year.
>
> ***

As Kaminska explains (boldface mine):

> Central bankers, after all, have had an explicit interest in introducing e-money from the moment the global financial crisis began…

Bitcoin has helped to *de-stigmatise* the concept of a cashless society by generating the perception that digital cash can be as private and anonymous as good old fashioned banknotes. It's also provided a useful test-run of a digital system that can now be adopted universally by almost any pre-existing value system.

> This is important because, in the current economic climate, **the introduction of a cashless society empowers central banks greatly**. A cashless society, after all, **not only makes things like negative interest rates possible** [background here, here, here and here]**,** it **transfers absolute control of the money supply to the central bank**, mostly by turning it into a universal banker that competes directly with private banks for public deposits. All digital deposits become base money.
>
> Consequently, **anyone who believes Bitcoin is a threat to fiat currency misunderstands the economic context**. Above all, they fail to understand that had central banks had the means to deploy e-money earlier on, the crisis could have been much more successfully dealt with.
>
> Among the key factors that prevented them from doing so were very probable public hostility to any attempt to ban outright cash, the difficulty of implementing and explaining such a transition to the public, the inability to test-run the system before it was deployed.
>
> Last and not least, they would have been concerned about displacing conventional banks from their traditional deposit-taking role, and in so doing inadvertently worsening the liquidity crisis and financial panic before improving it…

Almost of all of these prohibitive factors have, however, by now been overcome:

> 1) Digital currency now follows in the footsteps of a "disruptive" anti-establishment digital movement perceived to be highly accommodating to the black market and all those who would ordinarily have feared an outright cash ban. This makes it exponentially easier to roll out. Bitcoin has done the bulk of the educating.
>
> 2) What was once viewed as a potentially oppressive government conspiracy to rid the public of its privacy can be communicated as being progressive and innovative as a result.
>
> 3) Banks have been given more than five years to prove their economic worth and have failed to do so. If they haven't done so by now, they probably never will, meaning there's unlikely to be a huge economic penalty associated with undermining them on the deposit front or in transforming them slowly into fully-funded fund managers.
>
> 4) The open-ledger system which solves the digital double-spending problem has been robustly tested. Flaws, weaknesses and bugs have been understood, accounted for, and resolved.

The balance of the article describes how the central bank digital currency would be launched, and Kazmina finds a plan developed by Miles Kimball of the University of Michigan to be thorough and viable.

Oh, and why would Bitcoin, um, central bank digital currency make it viable to implement negative interest rates? Kaminska tells us:

> …the greater the negative interest rate, the greater the incentive to hold alternative coins. The greater the incentive to hold alternative coins ,the greater the incentive to produce them. The greater the incentive to produce them, the greater the chances of oversupply and collapse. The more sizeable

the collapse, the more desirable the managed official e-money system ultimately becomes in comparison.

Either way, the key point with official e-money is that the hoarding incentives which would be generated by a negative interest rate policy can in this way be directed to private asset markets (which are not state guaranteed, and thus not safe for investors) rather than to state-guaranteed banknotes, which are guaranteed and preferable to anything negative yielding or risky (in a way that undermines the stimulative effects of negative interest rate policy).

So all these tales … of how liberating and democratic Bitcoin will be are almost certain to prove to be precisely the reverse. Hang onto your real world wallet.

The head of Signature Bank – Scott Shay – raised these same issues last month on CNBC:

Bottom Line: Too Early To Tell

It's not yet clear whether Bitcoin will be a force for good or a backdoor way for big banks – and *central* banks – to get people to accept a cashless society.

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