



BITCOIN BLOWBACK: BACK TO THE DRAWING BOARD?

The Crypto Currency Debate

The Bitcoin Debate

- My thesis that Bitcoin is a currency, not an asset or a commodity, got some pushback.
- Specifically, there were some who argued that since you can lend Bitcoin and earn interest, it is an asset, and since it is scarce, it is a commodity.
- While I don't believe that there is much basis for these arguments with Bitcoin, the crypto currency world is a diverse one and what is said about Bitcoin may not apply to crypto currency or ICOs.

The Value versus Price Debate

	To value	To price
Assets	Can be valued based upon expected cashflows, with higher cashflows & lower risk = higher value.	Can be priced against similar assets, after controlling for cash flows and risk.
Commodity	Can be value based upon utilitarian demand and supply, but with long lags in both.	Can be priced against its own history (normalized price over time)
Currency	Cannot be value	Can be priced against other currencies, with greater acceptance & more stable purchasing power = higher price.
Collectible	Cannot be value	Can be priced based upon scarcity and desirability.

Bitcoin as Asset: Counter Arguments

1. **You can lend Bitcoin out and earn interest**

- ▣ Since the interest income is then a cash flow, the argument is that Bitcoin is an asset.
- ▣ The counter is that you can lend any currency out and earn interest. If you do, it is the loan that you make that is the asset, not the currency itself.

2. **The Bitcoin network has value**

- ▣ Extrapolating from the tech space, where companies like large network companies like Facebook have value, Bitcoin has value because of the networking benefit.
- ▣ The counter is that an investor in Facebook is not valuing it highly because it has a big network, but because he or she makes money from making money off that network (by selling advertising).

Currency versus Commodity

- The essence of a currency is that its primary uses are as a medium of exchange or as a store of value. The key to a commodity is that it is an input into a process that has a utilitarian function.
- Oil and coal are clearly commodities, since they derive their value from the fact that they can be used to produce energy.
- It is true, as with currencies, that you can create an asset based upon a commodity. A share of an oil well is an asset not because you like or even need oil, it is because you hope to sell the oil to generate cash flows.

Bitcoin as Commodity: Counter Arguments

1. Bitcoin is scarce

- ▣ Argument: The algorithm imposed limits on Bitcoin effectively mean that it will be scarce and if it is scarce, it will have value.
- ▣ Counter: There are lots of scarce items (sand is scarce and so is bull manure) but if there is no utilitarian or aesthetic benefit, they will not be commodities.

2. Time and energy was spent "mining" Bitcoin

- ▣ Since resources were expended in the production of Bitcoin, it must have value as a commodity.
- ▣ Not really. Not unless you can point to it becoming useful as an input into producing something that we value.

A Commodity Argument for Crypto Currencies

1. Block Chains and Smart Contracts will create large disruptions in businesses: Block chains and the smart contracts that emerge from them will replace conventional contracts in many businesses, and that will generate cash flows to the contract providers.
2. Crypto Currencies are the lubricants for smart contracting: Crypto currencies are a necessary ingredient to make smart contracts work efficiently, and that the demand for them will then rise as smart contracting expands.
3. “Your” crypto currency will be one of the winners: Your crypto currency of choice (Bitcoin, Ethereum etc.) will become the winner or at least one of the winners, perhaps because it has the “best technology” for smart contracting or has the most buy in by the institutional players in the game.

Conclusion

- As you listen to arguments for or against crypto currencies, my only advice is that you go back to basics about the needs that they are filling and that you ask questions about their long term staying power.
- It is time for us to separate arguments about block chains/smart contracts from arguments about crypto currencies, since you can have one without the other.
- It is also time that we differentiate between crypto currencies, rather than defend them or abandon them all, as a bundle. Bitcoin, Ethereum, Ripple and ICOs are different enough from each other, not only in structure but also in terms of end game, that they need to be assessed independently.