

Unregulated Digital Cryptocurrencies Versus Regulated National Currencies: Is There a Danger?

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“I have arrived at the conviction that the neglect by economists to discuss seriously what is really the crucial problem of our time is due to a certain timidity about soiling their hands by going from purely scientific questions into value questions.” Friedrich Hayek (1899-1992), (in a conversation, on Feb. 9, 1978).

“Inflation is always and everywhere a monetary phenomenon in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output.” Milton Friedman (1912-2006), (in ‘The Counter-Revolution in Monetary Theory’, 1970).

“There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner, which not one man in a million is able to diagnose.” John Maynard Keynes (1883-1946), (in ‘The Economic Consequences of the Peace’. 1919, Ch. VI, pp. 235-236).

A few years ago, after the 2007-2008 financial crisis, some clever people, whose identity is hidden behind the appellation of ‘Satoshi Nakamoto’, devised a decentralized electronic system of payments, which is independent of the existing traditional banking system. It is based on a new form of digital ‘currencies’ or ‘electronic currencies’, the ‘[cryptocurrencies](#)’. Some observers have called the cryptocurrency innovation a sort of a new 21st Century [digital gold rush](#).

The *supply* of a given electronic cryptocurrency is backed by a mathematically constrained scarcity and by a ledger technology that prevents counterfeiting. The *demand* is supported by a speculative faith of some buyers that other buyers are going to push the price of that cryptocurrency higher and higher. Cryptocurrencies can only be transacted and used as a means of payment within the narrow framework of an electronic network of decentralized registers, which are supported by powerful computers and the Internet.

There are presently as many as 7,000 such digital or virtual cryptocurrencies on the Web, and they serve as a playground for big and small speculators, besides being used as a

convenient conduit to make international money transactions, in total anonymity. Even private companies, such as Facebook, are considering launching their own commercial cryptocurrency.

The Bitcoin was the first cryptocurrency using the blockchain technology

The first cryptocurrency surfaced in 2009 with the [Bitcoin](#), a decentralized and international private digital 'currency'. It is the product of the application of a relatively new computerized technology, the blockchain. In order to limit the supply, the maximum stock of Bitcoins in existence was mathematically and electronically set at 21 million units, so that any increase in demand, once that threshold has been reached, must involve the exchange of existing Bitcoin units or coins. This tends to push prices higher and higher.

The complicated process of creating cryptocurrencies

The [blockchain technology](#) is a computerized technology using chains of blocks containing data that allow information to be stored and transmitted through a large number of computers spread around the world.

Because of the speculative nature of each cryptocurrency market, its price, such as the price of one Bitcoin in dollars or other traditional currencies, is very volatile. It can fluctuate widely within a short span of time. This conveys the risk that [big speculators](#), with access to large amounts of money and sophisticated trading techniques, could game the system and impose big losses on smaller or inexperienced speculators.

To a certain extent, the world of cryptocurrencies can be assimilated to an unregulated online casino for speculators, and this could lead to the creation of a speculative mania. The [cryptocurrency](#) craze is somewhat reminiscent of the [Tulip mania](#) in Holland in the 17th Century. At one time, for example, a single rare tulip bulb could be worth more than the price of a house!

A serious problem: the process of creating cryptocurrency units requires huge amounts of energy

There is an important technical drawback to the process of creating cryptocurrency units: It requires enormous amounts of energy. As more and more cryptocurrency transactions need to be computerized, the network of computers required to solve the complex blockchain calculations must increase, along with the energy it takes to run them.

For example, a [study](#) done at the University of Cambridge, in the U.K., concluded that the network of computers used by operators or '[miners](#)' in the process of generating units of the first cryptocurrency, the Bitcoin, consumes more electrical power, in one year, than that used by the entire country of the Netherlands, a country of over 17 million inhabitants.

As the cryptocurrency phenomenon continues to grow, it will require more and more computers to complete one cryptocurrency transaction, and each transaction will end up consuming more and more energy. For instance, a few years ago, a single Bitcoin transaction required as much electricity as 80,000 Visa card transactions. Nowadays, according to the [Digiconomist](#) website, a single Bitcoin transaction uses as much electricity to complete as 735,121 Visa transactions, (or 55,280 hours of viewing time on YouTube). And this is increasing on a daily basis. Such a heavy reliance on energy could severely

threaten the long-run economic sustainability of the current process of cryptocurrency production.

Economist Friedrich Hayek's libertarian principle of privately issued fiat currencies

Beyond the technical jargon, it is worthwhile to know that the idea of having an international system of private money or monies, free of government interference, is an old libertarian dream. It is based on the belief that the private self-interest of competing private entrepreneurs can lead to a general welfare superior to that of government intervention, even when this involves the creation of money.

Indeed, in 1976, economist Friedrich Hayek (1899-1992), of the Austrian school of economics, published a pamphlet entitled [The Denationalisation of Money](#), (with a refined version, published in 1978). Hayek advanced the radical idea that sovereign governments should forgo their central bank's legal monopoly to issue national currencies and leave the issuance of money to private entrepreneurs.

However, at the time, the idea of having competing private currencies was not well received.

Some saw in it the transfer, to private operators, of the public revenues that governments and their central banks receive in the money creation process, called [seigniorage](#). Others feared that the idea of having multiple private currencies used as means of payments would create confusion and chaos in the economy.

It was also thought that private issuers of money would have an incentive to issue too much of it, and thus create inflation and a loss of purchasing power for the users. Many also anticipated that in times of financial crises, governments could not adequately intervene to stimulate production and employment, through an aggressive monetary policy, etc.

Some of these criticisms were the same arguments invoked in the 1930s to abandon the [gold standard](#), a rigid commodity-based monetary standard, which tied national currencies to gold. It was thought that such a system had contributed in causing the [Great Depression](#) (1929-1939).

For some thirty years, after the [Bretton Woods](#) agreement of 1944, the world was placed under a gold-exchange standard, with the U.S. dollar remaining tied to gold, and most of the other national currencies tied to the U.S. dollar, with fixed exchange rates. However, after the first oil shock of 1973, the gold-exchange standard was itself replaced by the current monetary system of [fiat money](#), i.e. a system of flexible government-regulated currencies, issued by a central bank that oversees the banking system. It is usually connected to other national currencies through flexible exchange rates, so as to maintain equilibrium in the external balance of payments.

Governments of major countries could begin competing between themselves in adopting official digital currencies and possibly ban private cryptocurrencies altogether

Some ten countries have already banned trading in private cryptocurrencies. This includes: China, Iran, India, Bangladesh, Morocco, Thailand, Uganda, Zambia and Nigeria. The last country to do so is Turkey. [Turkey's central bank](#) recently announced that it is outlawing the use of private cryptocurrencies, such as the Bitcoin, in payments for goods and services, a ban that took effect last April 30. It warns speculators that cryptocurrencies present

“irrevocable risks”, as the market is volatile and there is a lack of oversight. It also cited their use in “illegal actions due to their anonymous structures”. No doubt that other countries will follow their example.

Conversely, the governments of major nations have either announced that they intend to set up their own official digital currency or are studying the possibility to do so. For one, the Chinese government has announced its intention to launch an international [digital Yuan](#), possibly to be in full operation for the Beijing Winter Olympic Games of Feb. 2022. Obviously, the new Chinese digital currency for international use could eventually represent a [challenge](#) to the U.S. dollar as the preferred reserve currency, and to counteract the practice of various American administrations to impose economic and financial sanctions on other countries for political purposes.

More generally, the advent of a digital Yuan could force other governments to get involved in creating their own international digital currencies. Already, the [U.S. Fed](#) has announced that it is studying the potential costs and benefits of developing a digital dollar. No doubt that other governments in the U.K., Europe and Japan would likely follow suit with digital versions of their own currencies, such as a “[Bitcoin](#)”, a “Eurocoin”, a “Yencoin”, etc.

A world of legal public digital currencies, traded internationally, could be just around the corner, even if money and capital markets are far from being able to operate with digital currencies. Nevertheless, such a purely monetary development could have profound effects on the existing private digital cryptocurrencies. Over time, it could also upend the international and domestic payment systems.

Conclusion

The future may have in store a growing reliance on digital money, possible public digital currencies issued by a few major central banks. It should be obvious that if governments begin to compete in creating their own digital currencies, this could pose a serious challenge to the current cryptocurrencies in existence, the latter facing a real regulatory threat.

Similarly, in such a futuristic digital context, if it were to materialize, this would raise the issue of how to preserve individual economic freedom, when all financial transactions can be recorded and made available to governments, allowing them to track people’s incomes, spending and investment in real time.

It would be ironic if the libertarian monetary innovation of private cryptocurrencies, designed to free users from government interference, were to lead to a world of public digital currencies. Governments would then have even more power over people than today. A resurgence of barter could ensue.¹

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Notes

[1] A book of fiction that foretells such a political plot is [The Patriot Conspiracy](#), 2012, (also found [here](#)).

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