Golden Cyberfetters

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Over the past few months a number of people have asked what I think of Bitcoin, an attempt to create a sort of private cybercurrency. Now Alexander Kowalski at Bloomberg News directs me to this Jim Surowiecki article on Bitcoin, which is very interesting.

My first reaction to Bitcoin was to say, what's new? We have lots of ways of making payments electronically; in fact, a lot of the conventional monetary system is already virtual, relying on digital accounting rather than green pieces of paper. But it turns out that there is a difference: Bitcoin, rather than fixing the value of the virtual currency in terms of those green pieces of paper, fixes the total quantity of cybercurrency instead, and lets its dollar value float. In effect, Bitcoin has created its own private gold standard world, in which the money supply is fixed rather than subject to increase via the printing press.

So how's it going? The dollar value of that cybercurrency has fluctuated sharply, but overall it has soared. So buying into Bitcoin has, at least so far, been a good investment.

But does that make the experiment a success? Um, no. What we want from a monetary system isn't to make people holding money rich; we want it to facilitate transactions and make the economy as a whole rich. And that's not at all what is happening in Bitcoin.

Bear in mind that dollar prices have been relatively stable over the past few years – yes, some deflation in 2008-2009, then some inflation as commodity prices rebounded, but overall consumer prices are only slightly higher than they were three years ago. What that means is that if you measure prices in Bitcoins, they have plunged; the Bitcoin economy has in effect experienced massive deflation.

And because of that, there has been an incentive to hoard the virtual currency rather than spending it. The actual value of transactions in Bitcoins has fallen rather than rising. In effect, real gross Bitcoin product has fallen sharply.

So to the extent that the experiment tells us anything about monetary regimes, it reinforces the case against anything like a new gold standard – because it shows just how vulnerable such a standard would be to money-hoarding, deflation, and depression.