«Magic Doesn't Happen, Especially Not in Business»

In recent weeks, cryptocurrencies have lost billions in value. Not to worry, says author David Gerard. That money was never real to begin with.

By Oliver Fuchs (interview) and Rebeka Mór (illustration), 26.05.2022

English Deutsch

The Super Bowl is a curious thing in TV entertainment. It's one of the exceedingly rare cases where viewers actually look forward to the commercials. These are frequently among the best (or at least among the least annoying) that the industry produces.

This year, many of them were about cryptocurrency.

Arguably the funniest of them had a time traveling comedian named Larry David dismiss many of the most important inventions of their time; belittling the first wheel, dismissing the first toilet, sneering at the lightbulb and sniggering at the idea that anybody would want to go to the moon. Finally, he frowns on FTX, a smartphone app for trading cryptocurrency. «Don't be like Larry,» is the tagline at the end of the ad. «Don't miss out on crypto, on NFTs – on the next big thing.»

Crypto has been around since 2009. It gained popularity as an alternative to the financial system, which had so spectacularly crashed just one year before. Dissidents around the world have relied on it. It propped up Wikileaks after many payment services kicked the whistleblowing platform off their networks. It has sparked research in industry and academia – and just the other day, an assistant to U.S. Senator Cory Booker praised it's «incredible equalizing power and opportunity for the people who have been left out of the traditional financial system.»

Crypto, this «next big thing» as the Super Bowl and Larry David would have you believe, is finally breaking into the mainstream.

Or is it?

And if it is, is that a good thing?

Author David Gerard has been following crypto since its infancy. And the way he tells it, he instantly knew it was a terrible idea before he even really understood how it worked. Just by virtue of who actually came up with it.

David Gerard, what would be the best thing you can say about cryptocurrency?
It's very hard to think of something that's an unalloyed good, because, well, nothing about it works or works out well. And it's hard to even say that it gets people thinking. Because it gets them thinking things that are actually completely incorrect and don't work, and then they lose all their money.

That seems a bit harsh.
Crypto barely has any use case. The single use case for it is making payments that governments don't want you to make. Now, that's not an unreasonable thing to ask for. Sometimes governments are stupid and annoying, and they do dumb things. Sometimes, you just have to work around them. But most regulations are there because you shouldn't do the things they keep you from doing.

Alright, I gather from this initial assessment that you're not a huge fan of crypto. Have you ever bought or owned any crypto?
I have not. I had six Dogecoins on my laptop at one point. But then I reformatted my laptop, and they were gone.


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About the interviewee

David Gerard is the author of two (pretty harsh) books about crypto: «Attack of the 50 Foot Blockchain» is a history of Bitcoin and the crypto space, while «Libra Shrugged» tells the story of Facebook's failed attempt to create a cryptocurrency. He has a blog about blockchain and cryptocurrencies and lives in Great Britain.

Why, actually, would people want to make their own currency?
The reason they wanted to make Bitcoin is that a bunch of very sincere extreme libertarians – and they really were quite sincere, I think they were wrong, but they were sincere – thought that making a form of money that was independent of all governments would definitely be the best thing they could possibly do. And that it would make the world a better place. And, just coincidentally, if it took off, they would also get rich for free.

I bought some crypto during the pandemic on my phone. And now I have a new TV.
Cool!

Do you really mean that?
Some people win. Basically, it's gambling dressed up as an investment. Cryptocurrency, Bitcoin, NFTs – all of them mean: «you get rich for free.» That's the whole pitch. In the real world, there's no such thing as a functioning get-rich-quick scheme. Sure, you might win, but more probably, you will lose. Betting on horses is not an investment. Some get really rich doing that as well. There are professional gamblers that bet on horses, but not many of them.

Why do people see it as an investment then?
First of all, many people don't really know much about money and about the history of financial disasters. And many people are desperate, because the economy is really bad right now. It's easy to think that crypto offers a way out. Most of these people lose their shirts, though, because it's a zero-sum trading environment.

Why is it zero-sum? If it just continues to go up and up and up, then everybody gets rich.
They won't get rich in actual dollars. There's no income generated by a large pile of Bitcoin or crypto in general. It's not capital that you can invest in a business. It's not something that you can use to generate more wealth. It's just a lot of stuff that you can buy and sell. Now, you can come up with extremely fancy ways of doing the buying and selling, but fundamentally, every dollar that a winner gets out of it is a dollar that a loser previously put into it. And the winners are usually the big guys, while the losers are the retail suckers. It's not technically a Ponzi scheme, it just works a lot like one.

Again, that sounds quite harsh. Some of these coins are worth billions.
Try converting these «billions» back into actual money. As it turns out, it's

quite hard. Those numbers are fundamentally a promotional strategy to make you think that the crypto market is incredibly huge. These people are really fond of the number called «market cap.» All that means, though, is whatever the last price for a coin was multiplied by all the coins in existence. What it doesn't mean is that you can convert all of them into real money at this price.

Why not?
What happens to a share price if everybody tries to sell the shares at the same price? When you see a headline like «Bitcoin Lost $200 Billion in Value,» that money never actually existed. In terms of finance, crypto is actually really tiny. But it generates a lot of headlines because Bitcoin is in an asset bubble. So: «Number goes up!» And there is no more interesting story in finance than that.

That's all there is to it?
Look, this is an unregulated market. Sure, some crypto stuff actually happens in countries that have financial regulations. But the vast majority of crypto trading does not. Most of it takes place in offshore exchanges, which have literally no regulation in place. They are just offshore casinos, and they are frequently engaged in trading against the interests of their own customers. The original Bitcoiners envisioned an ideal of an entire crypto economy, where this stuff was treated as money. That never happened. And it is never going to happen. All that is left is speculation.

The last couple of weeks have seen a significant crash. Something called «stablecoins» lost all its value, which seems ironic. What happened?
The idea behind stablecoins is the following: Crypto goes up and down all the time. A coin might gain or lose 10 percent of its value within a single day. You can't have a trading environment in which the currency fluctuates this wildly. It's way too unstable. So people actually want to deal with dollars. But what happens when you start to get dollars near crypto? Your bank might start asking you inconvenient questions, like: Where did you get those tens of millions of dollars? Is it even yours? And why haven't you identified yourself? Are you a criminal trying to evade sanctions? Inconvenient questions like that. So crypto needed something that was sort of the equivalent of dollars.

Stablecoins?
Exactly. They are cryptocurrencies like any other, but they're pegged to the value of the dollar. The obvious way to do that is to say: «I've made these little tokens. If you give me one dollar, I'll put it in my bank account and give you one of these tokens, worth a dollar.» It sounds like a very simple idea. The trouble is the implementation.

What happened?
Remember, these people want to make money too. And as it turns out, you can't make a lot of interest when you let your dollars just sit there in a bank account. All the incentives are there to put this money into riskier investments, like giving out loans or just playing the markets. That means that there weren't actually a lot of reserves backing stablecoins.

It sounds like a bank making risky investments.
Except that, unlike banks, none of these stablecoin organizations ever went through an audit. They imply that they did. They say: «Here we have a statement written by auditors,» but these are not the real thing. For the biggest one of these, called Tether, this was actually documented. They borrowed $300 million, put it into their account, had an auditor confirm that they had

$300 million in their account, and then they just paid the money back right afterwards.

Is that what happened here? One of these «banks» crashed?
Yes and no. Because the one that crashed, called Terra, wasn't just a stablecoin, it was an algorithmic stablecoin. Basically, that means you get a pile of unstable and volatile – essentially trashy – crypto assets. You shuffle the numbers really fast by running a program on a computer. Because: Computer equals magic! And that then works for a while. But it can't work forever, because there is no amount of algorithmic shuffling that can protect you when the whole market goes down. Every algorithmic stablecoin so far has failed.

Why, then, did the value of Bitcoin drop when Terra failed? Some people say Bitcoin is essentially digital gold.
When Terra's value collapsed, the people behind it tried propping it up by pumping some Bitcoin from their currency reserves into it. That then crashed the price of Bitcoin as well. It was all an overleveraged chain of garbage. In crypto, this is almost a weekly event. Things like this happen all the time. Because all of this is just a very thin justification for putting a dollar price on things that do not work. In that sense, what happened is very similar to the financial crisis of 2008.

How so?
Back then, a bunch of money market funds had constructed dollar equivalents, because everyone wanted to trade things that could be priced in dollars. Housing prices in the U.S. were steadily rising, and they wanted to financialize that. So they built securities that were built on securities that were built on mortgages. A chain of leverage ending up in an alleged dollar. That worked fine until housing prices went down. The alleged dollar collapsed; the whole chain of leverage collapsed. And then the money market funds were in trouble. And since everyone depended on these funds, the whole U.S. economy faced potential collapse as well.

You make all of this sound quite risky. Why hasn't crypto seen much regulation thus far?
Real regulators don't worry too much about crypto because, as I've said, it's still tiny in terms of financial markets. What the regulators do worry about is these incompetent bozos getting their tendrils into the real economy. You know, the one where people actually live. That would be a disaster, because they'd be turning crypto into pension funds, investments in banks and so on. For now, it's mostly hedge funds. I don't worry too much when it's rich guys killing each other. I worry when moms, granddads and desperate young people get sucked into this. Governments get worried when crypto gets to the level where it can affect the real economy. The guy who created Terra has been summoned to explain himself to the South Korean parliament. They are worried about his stuff because South Korea is a relatively small economy. It's a relatively prosperous country, but it's not very big.

Switzerland is also pretty small. And we have this canton called Zug that wants to become the crypto valley of Europe. You can buy Bitcoin at the SBB rail network's ticket machines.
Yeah, I saw that.

Should we be worried?
You don't have to be worried as long as people don't suddenly decide that the Swiss franc is no good anymore. I don't think that's going to happen anytime soon. Because it turns out that the Swiss franc is a pretty solid currency. It is readily exchangeable for euros and dollars, and for other curren-

cies that everyone else uses. As for your valley, well, a lot of people there talk about big numbers and big plans. But all the good stuff is in the hypothetical future.

The future where blockchain solves all of our problems?
If Bitcoin and crypto are the promise to get rich for free, the business version of this promise is that blockchain will give you organizational efficiency for free, or will fix your data for free. And that doesn't happen either.

But it's an interesting technology.
The guy that created Bitcoin, he goes by the pseudonym Satoshi Nakamoto, never claimed to have invented any new technology. He recombined existing technologies in a particular and interesting way. Bitcoin is indeed very interesting. It's not feasible, it's not a good idea, but it's definitely interesting. In computer science, blockchains are called a Merkle tree. By now, they have been around for decades. It's basically a ledger that you can only add entries to. It has a few uses. But it isn't magic. Because magic doesn't happen, especially not in business.

That sounds a bit too simplistic, frankly. Many companies are interested in the technology and are doing research on it.
Did you know that the interest companies show in blockchain actually closely tracks the price of Bitcoin? When it experienced a bubble in 2017, Bitcoin went up. That's when a lot of businesses tried to get into blockchain. People bought in, it was exciting – and then Bitcoin crashed. The price went down, and interest in blockchain with it. IBM promoted blockchain more than anybody back then. They ended up closing their blockchain unit entirely. Then in 2021, Bitcoin again experienced a bubble. And what happened? Interest in blockchain came back. If any of this stuff really worked better than existing systems, it would have been universally adopted years ago. Take money transfers across borders – particularly remittances. If crypto were better or cheaper, Western Union would use it, Visa would have implemented it years ago, and banks would be full of blockchains. None of which is the case.

Why do people have such short memories when it comes to previous crypto crashes?
Because people have a lot of hope. And they're desperate. People get hurt, get out, and in comes a batch of fresh victims.

Like me wanting that new 55-inch OLED flat screen TV.
You were lucky. And well done! But always remember that you were lucky. And some people go all in. When Terra collapsed, they had a suicide helpline pinned to the top of their board on Reddit.

In retrospect, that was probably not ideal timing for Mr. Bean to come out with an NFT. There was a really great headline in Bloomberg in April last year calling NFTs a «stimulus-led fad.» Most of the NFT market was fake anyway – so-called «wash trading,» where two insiders trade between themselves to jack up prices until a mark falls for it. A lot of companies tried to hop on board. And the public mostly hated it. The gaming company Ubisoft did an NFT project. They made $396.

What do you think those sincere libertarians think about how their dream turned out?
I don't know. There are still a lot of very sincere extreme libertarians in Bitcoin and in cryptocurrency in general. But there are a lot more people who are just in it to get rich, where «number go up» is the only ideology they have.

What do you think comes next?
I think this slide will continue through 2022. The bubble will not go «pop!» all at once. It will slowly deflate. A lot of people actually left last summer, and ever since, there has been a lot of frantic promotion to keep the party going. But everybody knows the music has to stop at some point. If crypto sticks around, there will probably be another bubble in 2025. I did not predict NFT's, but I will state that they will come up with a new and exciting excuse to sell you made up tokens that aren't worth anything.

Recently, some have voiced concern that this crash might radicalize a lot of people, that those who were already on a right-wing path might now become even more disillusioned, perhaps even extreme. What do you think?
I don't see that as a huge risk. I follow that particular angle a lot –Bitcoin and extremists, Bitcoin and Nazis, and so on. Crypto is not a Nazi subculture, but Nazis are interested in Bitcoin. The reason is clear: They constantly get kicked off real payment systems and turn to cryptocurrency to get paid. Sure, some Nazis are actually ideologically libertarian. But most of them just want dollars, like anybody else. There's some unfortunate crossover, but they are not the same subculture. Crypto people see things like neo-Nazis shooting up churches and synagogues and mosques, and they are just as horrified and disgusted as everybody else. So no, this crash will not radicalize people any more than the actual real conditions in this economy already have.