The Crypto Craze /Craziness

The current penchant for individuals to acquire crypto items, fueled by incessant marketing and word of mouth recommendations from prior acquirers, is bound to end in tears. And some institutions have also succumbed.

The reader may note that I haven't used the terms "invest" nor "crypto assets". First, while there may be some race-track punters who refer to their flutter on a nag as an investment – it really is a speculative bet or gamble. So it is with decisions to exchange real money for ownership of BitCoin, Etherium, etc.

Second, the term "asset" implies the item being either a liability of the issuer, or representing ownership of some underlying physical (tangible) or intangible item which has the potential to be used to generate future income or services of value. The only possible value of crypto items is that some other gambler may be willing to purchase them at a higher price.

This is not to say that the technological advances involved in the creation of crypto items have not involved some real value. The blockchain concept (although possibly overhyped) can have value as a decentralized alternative to a centralized register of ownership and transactions. Likewise, the ability to create contracts which contain contingent clauses which automatically take effect when the event specified occurs can also provide value.

But these are technological advances resulting from a digital age and which are not reliant on being connected to some crypto item. But, their link to crypto items gave a way for their creators to monetise the fruits of their innovations.

To explain, note that governments have traditionally benefited from "seigniorage" when producing and issuing fiat money (notes and coins). The term "seigniorage" refers to the profit to the issuer from being able to exchange an item (fiat money) which costs them virtually nothing to produce for something of value (goods and services).

The initial creators of cryptos such as BitCoin also receive seigniorage if there are punters who are willing to buy the initial stock issued in exchange for "real" money. But the tricks required are first to convince such punters that the cryptos will be likely to increase in value and, second, that the creator won't be lumbered with costs from keeping track of ownership of cryptos as they change hands.

A mechanism which limits the future growth in supply, as built into BitCoin, is one element. Provided the demand by new punters exceeds the allowable growth in supply, the price will increase – prompting selfreinforcing expectations. And existing punters have an incentive to "talk up" the crypto merits to create that increased demand.

The second element is the outsourcing of recording and verifying transactions to the public block-chain mechanism, whereby those doing the verifying receive a reward of new cryptos according to the underlying algorithm.

So, the initial creator foregoes additional seigniorage on those new cryptos, but the verifier / recipient of new cryptos does not necessarily make an equivalent profit. Expenses (electric power, computer resources) incurred in the verification process, reduce the profits towards zero – particularly when there are many competitors in the verification market.

And a great waste of resources (energy, computing) is involved.

The social tragedy is that entry into the market for crypto creation is free and relatively simple, such that a wide variety of new cryptos can (and has) emerged. Punters can be attracted to alternative cryptos via marketing, and if the process of becoming a participant is relatively simple.

Therein lies a second aspect of resource wastage. Most punters will need to avoid the complexities of direct crypto ownership (storing and remembering complex codes or passwords) and deal through an intermediary such as a crypto-exchange.

In principle, the waste of resources involved in creating and operating crypto-exchanges is no worse than that in other spheres of gambling. But at least in those cases, it is recognized as gambling.

The crypto craze involves unsophisticated and poorly informed individuals being lured into an activity which is gambling, but marketed as an investment opportunity. The potential for losses from price fluctuations, failure of intermediaries, and fraud is high. And even fund managers and sophisticated investors, lured by some past price increases (fear of missing out) and absurd arguments about crypto price fluctuations providing a hedge for other assets, are not exempt from crypto-craziness.

While there is much that society can gain from innovations based on digital technology, cryptos do not qualify as a socially beneficial invention, and warrant firmer regulatory oversight.

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