



FROM

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On The Possibility of Outlawing Cryptocurrency



Cryptocurrency is an asset that central banks do not control. Of course, if the government wanted to make it illegal, it could do so. The government made liquor illegal for a decade. However, that did not stop anybody from buying liquor. In other words, the government could make anything illegal, but that is not the issue. The issue is whether the people will obey the law.

Unfortunately for governments, such action is futile with respect to cryptocurrency since it is based upon open-source code and, within hours, a banned cryptocurrency will appear again under another name. This has actually happened, and a real-world example will be discussed below. A government may undertake to make all cryptocurrencies illegal. However, to successfully accomplish this, it would be necessary to police all the computers on the planet. Since laptops, iPads, smartphones, and other devices are also computers, this probably amounts to policing at least 2 billion devices.

Let's bring the discussion to economics, using currencies to illustrate. At various points in the last 200 years or so, many nations around the globe made trading in currencies illegal. In other words, they established a fixed exchange rate, and exchanging one currency for another had to be done through the central bank at the official rate. The list of nations that have done this is very long. All of these governments had to abandon their efforts, because people did not obey that law. Here are some examples.

If one consults the book entitled *Good Money* by George Selgin, one can read of the attempt by the British manufacturers to create tradesman's tokens to be used as money, given that the Royal Mint consistently refused to produce sufficient small-denomination coinage for ordinary business activity. This eventually became the most popular money used in Great Britain until 1821, when all money, except government-issued, was outlawed.

Venezuela made bitcoin illegal, with life imprisonment as the penalty for trading in bitcoin. A pretty serious penalty. Do you know what happened? People traded in bitcoin. How did they do it? They

travelled to neighboring Brazil, got hold of some servers, and they mined bitcoin in one of the data warehouses. When they earned the bitcoin, they would sell it or use it as payment to buy food, medications, and other necessities, which they shipped into Venezuela. The government basically had to throw up its hands. Even Venezuela's fairly repressive government could not stop Venezuelans from using bitcoin.

North Korea is another example. In North Korea, the penalty is death for trading the North Korean won versus another currency. People do it anyway. If you can believe it, there is even a website that tracks the black market of the North Korean won on a daily basis, so obviously it is a fairly large market.

Iceland made Bitcoin illegal. In March 2014, unknown computer experts, however, created an alternative to Bitcoin named Auroracoin. In March 2014, 50% of the Auroracoin was distributed to all 330,000 people in Iceland, using the registry of the Iceland National ID system. This translated to 31.8 Auroracoins per person. The creators unilaterally declared that each Auroracoin had the value of \$12.11 per coin. It was announced that more coins were to be issued and further issuance did take place. Of course, the market paid no attention to the "established" value of \$12.11 per coin. The initial trading value was low. It was quickly established that the trading value of Auroracoin was .001 Bitcoin. Only about 24% of the Auroracoins issued were claimed by Icelanders. The issuers destroyed the unclaimed balance. If the Icelandic government cannot control the money of only 330,000 Icelanders, one-third of whom conveniently live in Reykjavik, it will be much more difficult for the world's governments to control the planet's 7.8 billion people.

We can go on and on, with such examples throughout history. Governments have not been able to do it anywhere. No matter what law the government passes, that law really will not affect bitcoin trading, because that trading allows people sufficient income to enjoy a more comfortable standard of living.

There are other populations whose money is being debased by government policies, and those people do not have enough income, so the value to them of the illegal currency is a matter of life and death; it is a matter of survival. One could say they are obligated to obey the law because they are citizens of the nation, but when one's life is at stake and the lives of one's family are at stake, what are people likely to do if the value of the national currency is debased—which is to say their life savings and their paycheck? The government may say it needs to debase the currency for a policy reason, such as that it does not have the resources to pay off the national debt, and that might be a very legitimate policy reason. It does not mean people will obey the law and sacrifice their lives.

In fact, no matter how tyrannical a government might be, it cannot stop, and never has been able to stop, the development of consensus money. If the North Korean government cannot stop the development of consensus money with threats of torture and executions, more liberal regimes certainly cannot stop the development of consensus money. Bitcoin and other cryptocurrencies are not legal tender; rather, they are consensus money. History records that legal tender is a very poor substitute for consensus.

The problem with government-issued money is that governments routinely abuse the privilege of money creation. Historically, the temptation is to make use of the money creation faculty for the

purpose of preserving and extending political power, and the temptation has been irresistible. It is for that reason that Friedrich Hayek published *The Denationalization of Money* in 1976. In this book, Hayek advocates the establishment of competitively issued private monies. In this circumstance, the central bank and fiat currency would still exist. However, a person dissatisfied with the continual loss of purchasing power aspect of fiat currency could switch to private money as a store of value. So, neither the concept nor the desire is new.

We have not seen any instance ever of outlawing currencies or currency exchange being successfully executed, and I have been looking for such instances for many decades. Even if there is such an instance and the citizenry passively obeys the law, when has a government been able to stop the black market?

The market will value it however the market will value it. The point is that it is a preposterous notion that the government can determine the market or the clearing price. That is really the same as arguing that the government can control the economy, that it is a lot better at it than the collectivity of all the entrepreneurs. Controlling an economy has been tried in many, many instances, and each time it has been a calamitous failure. There is no instance of a government coming even close to doing it successfully.

There is an entity known as Room 39, which is one of the unofficial names of The Central Committee Bureau 39 of the Worker's Party of North Korea. Room 39 has a long history of counterfeiting U.S. \$100 bills, but its technology is now such that their counterfeit dollars are known as super dollars, because they are essentially indistinguishable from U.S. currency. North Korea has a powerful incentive to print dollars and Chinese Yuan. We simply do not know the extent of the problem. If, as a technical flight of fancy, Room 39 somehow successfully made the same effort in cryptocurrency, though, it would succeed only once, provided that their cryptocurrency were sold almost instantly. Instantly, because the price would collapse as soon as the miners and other supporters of the bitcoin blockchain learned that it had been hacked and the supply limit breached. The counterfeit bitcoin would be worthless.

The most significant problem with fiat currency is not counterfeiting; it is the ability of governments to legally create discretionary additional supply and, thereby, reduce the value of the existing currency.

One could theorize that maybe one day some government will be clever enough and have enough agents to properly surveil every member of society to ensure that currency controls are followed. However, consider North Korea: it seems to have applied a lot of effort and personnel in surveillance, yet it cannot seem to make the population abide by the laws about bitcoin. And North Korea does not even have a large population. In fact, North Korea probably tries a lot harder than other governments.

These kinds of laws used to be called "capital controls." A government would not let anyone take money out of the country, because it did not want its currency swapped for another nation's currency. In other words, capital controls were an attempt to prevent the national currency from leaving the country for the purpose of entering into a transaction to sell it somewhere else. Governments did not want such transactions to take place, so they prevented people from taking money out of the country.

So, what would one do if one really wanted to get money out of the country? One would buy something of value within that country, paying with the native currency, and take *that* out of the country to sell.

Diamonds were commonly used for that purpose, because they cost a lot of money but are very small so they can be easily concealed. People interested in leaving a country with their wealth would sell their cash for diamonds, and move the diamonds out of the country. Once abroad, they would sell the diamonds in exchange for the currency of the nation in which they wanted to reside. This also was done with art work and with rare books.

Speaking of which, rare books are another example of clandestinely transferrable wealth. Many people in a nation with capital controls would buy a rare book or several of them. To make it more interesting, they might have purchased a rare book in a foreign language. They did not even try to hide it as they left the country; after all, it was just a book in a suitcase. If the suitcase was thoroughly searched, the authorities would just see a book, and rarely did they realize that that it was worth, say, \$1 million. It probably did not even look that old, since it would be well-preserved. The title of the book, being in another language, would not mean anything to anyone searching the suitcase even though it might have been a rare first edition of a novel.

One might have taken three or four books out this way, because it would not be unusual for somebody to bring three or four books to read on a long vacation, especially if one were going by ship and would have a lot of time to kill. Nobody would have thought there was anything unusual about it. If a family of several people was leaving, there was nothing unusual about having three, four, five, or even six books in a suitcase. One could say every member would read one or two books. One might have walked out of the country with \$10 million worth of rare books, but the authorities never knew. Rare books come in any size, any condition, any author. Some are innocuous, such as comical novels or scientific texts. They would not arouse any suspicion to a Customs agent. People did it all the time.

The Bettman Archive is a classic example of government transit security agents not recognizing extremely valuable objects. The Bettmann Archive consists of photographs collected by Otto Bettmann, a former librarian in Germany. Bettmann had been working on the Archive before the Nazis came to power in Germany. He left Nazi-controlled Germany with the Archives in 1935. He went right through German bag searches because all that the government security agents saw were boxes of photographs that they thought were meaningless. The photos were pictures of people in parks, playgrounds, etc., and there was nothing political or unusual about them. They passed muster even in Nazi Germany, yet the Bettmann Archives were worth a lot of money. Ultimately, Bill Gates bought the entire Bettmann Archive for over a billion dollars.

As a matter of fact, one could carry wealth across borders with memorabilia. Some sports memorabilia, baseball cards, and comic books are worth small fortunes. The original Barbie Doll from the 1950s was known as Bild Lilli in Germany, where it was invented; it is worth a small fortune. Actually, it is worth a *large* fortune. If a government security agent finds a Barbie Doll in a piece of luggage, does one actually think that security agent will realize the doll is being hidden—that is, hidden in plain sight, so to speak? Does one really think that a Customs or security agent who is not a collector him- or herself can

distinguish the original Barbie Doll, which is worth a fortune, from a current Barbie Doll, which might be worth somewhere between \$5 and \$40?

The idea that the government and its agents can value everything is in itself a preposterous notion. Even the most astute investor on the planet cannot value everything. There are people who are brilliant at picking stocks, but they know nothing about rare books. Why would you expect a Customs or transit security agent to have that knowledge?

Unless Customs and transit security agents are omniscient, they are not likely to control the flow of value across borders. That is why efforts to do so have always failed.

If people agree something has value, it has value. If there are people willing to pay a fortune for *Iron Man* Number 1, then it is worth a fortune and there is nothing the government can do about it.

Another fallacy is on whether bitcoin imposes a threat to replace fiat currencies and hence will be banned. Bitcoin would not replace them, it would *displace* them. Bitcoin would run parallel to the fiat currency. The government would never borrow money in fixed-supply cryptocurrency, because it is not inflationary. Why would the government agree to borrow money in a strong currency that does not get debased? It would be an act of stupidity, because future bond maturities would have to be repaid with more money than was raised when the bonds were originally sold. The government would continue to borrow money in fiat currency.

There will be a vigorous market for fiat currency. Some people will insist on transacting in fiat currency, and others will insist on holding cryptocurrency. For example, when the euro was created by the European Union, it did not displace the dollar and the yen. They did not expect it to do so. No one in the U.S. and Japan would say, "Okay, that's it for the yen and dollar, now we will just use euros." The value of the euro changed relative to the yen and dollar, but people did not stop using those currencies.

It is not easy to destroy a cryptocurrency. A company can become bankrupt; a bond can default; however, crypto is just a bit¹. Even if its price falls to a penny, it can still operate and trade; hence, it has an infinite life. It is an infinite-life put option on fiat currency that one day will be valued as such.



¹ A bit is a basic unit of information used in computing and digital communications

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