



Rodney's Take

September 27, 2021

China Is the First To Ban Cryptocurrencies

Last week, the Chinese government declared it illegal for Chinese nationals to trade in cryptocurrency, no matter where the transactions take place. Then the government went further. They also made it illegal for Chinese nationals to work for any company that facilitated cryptocurrency trading, such as exchanges, and for any institution to work with such businesses.

The People's Bank of China (PBOC) issued this statement:

“Recently, cryptocurrency speculation has increased, disturbing economic and financial order, breeding illegal and criminal activity such as gambling, illegal fundraising, fraud, pyramid schemes and money laundering. This all seriously endangers the people’s safety.”

So it's all about people's safety. Right.

I won't bore you (for too long) with the economics, but the Chinese sit on the horns of a trilemma—the Mundell-Fleming trilemma, to be more precise. The premise is that a nation can keep only two of the following three economic policy goals going at one time: a managed (fixed) currency, managed interest rates, and free capital flows with other nations. You can't have the “good stuff” that evens out your economy (fixed currency and managed interest rates) and still have free-flowing capital in and out of the country. At some point, your policies will be at odds with the world, with

currency valuation or interest rates out of whack, and capital either will flow in so fast as to overwhelm the financial system or flow out so fast as to send the economy into a death spiral. For real-world examples, look at what happened in Asian nations in the late 1990s.

The Chinese want it all. They manage their currency and interest rates and keep a tight rein on capital flows, which causes friction in their economy as people and businesses try to maximize wealth. If you think the Chinese yuan will lose value against the U.S. dollar, you can't move your money to the greenback. This makes foreign investors hesitant to put money into China, because they aren't sure they can get it out.

Thousands of other concerns also exist for those who directly invest in a foreign nation or manage assets, but the overriding idea of the trilemma is always at play, which is why the Chinese are cracking down so hard on cryptocurrencies. Digital dollars are an easy way for people and companies inside China to move wealth anywhere else around the globe, and that's something the government cannot tolerate, because it reduces their economic control.

It is not a coincidence that China is taking this approach just as it rolls out digital renminbi (e-CNY), which is controlled by the PBOC. The central bank claims that e-CNY has all the benefits of cryptocurrencies, such as ease of payment and storage, without the shady side. Of course, you also can't move your e-CNY outside of the country, which is the point.

Look for some version of the Chinese crackdown in a country near you.

While it's unlikely that U.S. government or European officials would move to make all cryptocurrency transactions illegal, they face one big issue that haunts the Chinese government. If a substantial number of people move to cryptocurrencies, even stablecoins, which require deposits in state-sponsored currency, then central banks will lose some power over monetary policy. What if the Federal Reserve or European Central Bank adjusted interest rates and no one cared? There's not a government banker or politician on the planet that wants to give up control over money.

Western governments aren't likely to declare cryptocurrencies illegal. Instead, they'll use agency restrictions and cumbersome tax policies to make dealing in cryptos as difficult and unattractive as possible. But that doesn't necessarily mean that cryptos will lose value. People are funny about their accumulated wealth and control over their assets. The harder governments squeeze, the more likely it will cause a backlash, at least in the West.

While Bitcoin and other digital dollars took a hit after the Chinese announcement, I think they will bounce back. As I've said before, I think Bitcoin is much more likely to become some version of digital gold than to end up as a currency used for ordinary transactions, and gold still has value, no matter what its detractors think.

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