Bitcoin: Trojan Horse

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Dear SEC,

Paraphrasing Augutin Carstens, the general manager of Bank of International Settlements: Money is not just technology, but also the right legal framework, together with good economics.

Will make my points of concern as concisely as possible. I will raise 3 questions that alludes to the problem with Bitcoin ETF.

Does legitimizing Bitcoin endangers US national security? Everybody knows about the 51% attack and that 75% of Bitcoin mining is in China, but I think another important risk comes when we integrate Bitcoin into our financial system by embracing it with regulatory control and oversight. What we come to integrate will open our financial system with added channels of dependencies and vulnerabilities. It is one thing for Bitcoin to be a hobbyists fascination but it is another thing when it becomes tightly coupled to our financial system, with participation from our institutions. What happens when zero knowledge proof technology advances such that conducting AML becomes expensive or impossible? Are we not endangering our national security not only from China but also providing a platform for rogue states like North Korea to participate in the global financial system. Adversaries don't drive their existential decision process based upon economics. Is there no safety backstop if the code fails due to some unknown unknown? Isn't that fragility in the most extreme sense? Coupling our financial system to Bitcoin will provide them with a far larger target, than just Bitcoin alone.

Does Bitcoin have a floor to its valuation like USD (US dollar)? You often hear the argument made that Bitcoin is no different from USD, in that USD also has no intrinsic worth. However, this doesn't seem to be true because USD has legal standing, for all intents and purposes. I know, that I can always pay my debt in USD. The lender can not legally refuse to accept USD as debt repayment. Therefore, USD does have some monetary floor to its value. In fact, arbitrage arguments can be used to validate that USD does have such intrinsic worth. However, a lender can not be compelled to receive Bitcoin as repayment, so it is entirely possible for Bitcoin price to go down to zero. If Bitcoin doesn't achieve the anticipated financial participation and legitimacy, what will likely happen to the dramatic price rise of Bitcoin? Is the need for transaction demand causing Bitcoin price appreciation? I think many would have more confidence in the viability of Bitcoin if the price appreciation was correlated with increasing commercial usage rather than the exuberance from regulatory legitimacy. That's why Bitcoin rest on weak foundation of mere expectation and can go to zero.

Can Bitcoin undercut Federal Reserve's ability to conduct monetary policies? I don't think this issue has been fully investigated and should be before further legitimizing Bitcoin as an ETF. Assuming Bitcoin works as designed, when the Fed pursues an expansionary monetary policy, can the market forces undercut the effectiveness of the policy with such a competing currency, as a haven. Can the Bitcoin be rehypothecated? How will the rehypothecated Bitcoin enter the blockchain? What will be the expansion of credit under Bitcoin, as with USD? I think such issues need to be addressed

before we further couple Bitcoin into our financial system. These are questions that obviously need to be addressed given how instrumental our monetary policy tools were in rescuing our economy from the precipice of Financial Crisis of 2008 and COVID crisis of 2020.

Someone amusingly stated that Bitcoin is like a Tesla but with a lot of used batteries. The risks may be far greater. It may be a Trojan Horse, looking for regulatory welcome from the many marveled by the new technology. What may be from the gods, may be from Kim (the real Satoshi, by the way). Once we let in through the gates, the consequences may be irreversible, just like a Bitcoin fat finger transaction or a misplaced private key. Given that money is not just technology but also, law and economics, then when Warren Buffett and Charles Munger weighs on the side of caution, with their time tested principles in the latter two, while praising the technology itself, it is probably as good as any counselled advice.

Sincerely yours,

J.C.

Why is Bitcoin not a digital gold?

Money is widely known to serve 3 purposes: unit of account, medium of exchange, and store of value. Now, the new popular narrative is that Bitcoin will primarily function as store of value, like a digital gold, replacing the original narrative as medium of exchange, given the ongoing technical and practical challenges there. However, has Bitcoin achieved the function of store of value? Here are 3 reasons why Bitcoin has not demonstrated the function as store of value.

First, unlike gold, Bitcoin is not a collateral currency. Central banks hold gold because it can be a ready source of foreign exchange, especially for USD, during times of crisis. Ideally, foreign central banks would like to establish a swap line agreement with the Federal Reserve to convert their local currency to USD, to be triggered in times of emergency. During such crisis, access to USD funding becomes expensive or impossible, resulting in local banks risking default due to its inability to continue to fund their USD positions. Such swap lines between central banks become an insurance when such crisis happen. However, such swap lines are a risk to the Federal Reserve. If the sovereign defaults, then Federal Reserve is left holding losses from depreciated foreign currency. Therefore, allocation of such swap lines are generally given to sovereigns with good credit standing. An alternative to such swap lines are gold. Gold can also serve as a collateral to access USD during such crisis. That's why gold has value because of its repeated historical pattern acting as insurance to access liquidity during times of extreme crisis. As of now, Bitcoin has yet to demonstrate the role as a collateral currency, let alone for central banks.

Second, I argue that Bitcoin is an example of 'fake it till you make it'. Bitcoin speculation is driven by expectation of increasing institutional participation by wall street, main street, and government. All facets of centralizations that the Bitcoin community once had low regards. Such expectation is built on the hype that the pretender is the rightful king. For example, if the government decreed tomorrow that turtle shells can be lawfully used to payoff debt, then immediately we will see turtles become endangered, turtle shells appreciate in value, not from any merit of turtle shells as money, but merely from a definitional change in its legal standing. The crypto lobby is actively working in the same direction to link themselves to the existing system, with Bitcoin ETF as the immediate desired prize. Anticipation of legitimacy is what has been driving the appreciation of Bitcoin. That's why I believe that Bitcoin price rise is a form of 'fake it till you make it'.

Lastly, the most obvious reason is that Bitcoin is far too volatile. Generally, assets that are deemed to be a store of value should have risk characteristics that matches stability and not the level of volatility that we continue to witness. Clearly, Bitcoin is far too volatile, with potential risk of becoming worthless as well. Can the head of risk management at banks or at corporate treasury actually give greenlight to Bitcoin, given the possible scenario of Bitcoin value falling toward zero? If we have learned anything from past crisis, the impossible is not as improbable as our best models assume. That's why Bitcoin has yet to prove itself to be a store of value.

Let's not let 'fake it till you make it' a possibility for the fake digital gold. Let the technology prove its worth first by demonstrating convincingly the 3 functions of money. I see blockchain technology as a truly novel innovation that can improve civilizations but its beta versions of money still is wanting.