Bizantine Capital

China, Crypto, and the Decline of the Dollar

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You may or may not have heard President Xi Jinping's recent speech on blockchain technology. Here's a highlight if you haven't:

"The integrated application of blockchain technology plays an important role in new technological innovations and industrial changes. We must take the blockchain as an important breakthrough for independent innovation of core technologies, clarify the main direction, increase investment, focus on a number of key core technologies, and accelerate the development of blockchain technology and industrial innovation. It is pointed out that relevant departments and their responsible leaders should pay attention to the status quo and trends of blockchain technology development, improve the application and management of blockchain technology capabilities, and enable blockchain technology in building network power, developing digital economy, and assisting economic and social development. They must play a bigger role."

News broadcasts are one of the few windows into Chinese politics—the general Chinese public relies on them to gauge and confirm their sentiments of the Party. Xi's speech was compiled with additional news about China and blockchains. Members of the People's Party announced that they had signed their allegiance to the Party on a blockchain. The Party made it *illegal* to call blockchain a scam. The Party released informational materials on Bitcoin and Ethereum. Baidu, China's google, experienced 14x search growth for 'blockchain'. Chinese VCs are now re-entering the market. Shenzhen, China's tech capital, made numerous announcements about how it's already been using blockchains. Binance, the largest cryptocurrency exchange, is now pushing for a location in Beijing.

Two summers ago (2017), China banned cryptocurrency trading. The recent change of public sentiment came out of nowhere. China is unique in that one person really does control everything. What Xi says goes. Centralization of decision making allows for quicker decisions, playing part in China's incredible rise. It also increases the risk of failure: if Xi screws up, the country screws up. Granted, Xi hasn't showed any signs of screwing up yet.

Why the change of heart

Xi's announcement is most likely due to the realization that blockchain technology, through either a public, 'digital gold' cryptocurrency (i.e. Bitcoin, Ethereum) or a fiat-backed cryptocurrency (i.e. Libra, People's Bank of China coin), can displace the US dollar. Xi, Putin, the EU, England, and others have publicly voiced their frustrations about the dollar's status as the reserve currency.

The benefits of being the reserve currency

In short, it provides a basis of support for your economy. A slightly longer answer: you'll always have the most buyers of sovereign debt, which means you'll have more capital than everyone (and at favorable rates); overtime, capital compounds, so your lead over others increases, so long as you use your credit wisely, which hopefully the US treasury does. America's greatest export is its debt.

Holding a significant amount of American debt also places all other central banks at the whims of America. If the US economy goes belly up, then so does everyone's. In a world of relativity, there's no better position to be in than that.

Due to the benefits of becoming the reserve currency, Xi has had an aggressive strategy of trying to get the RMB into as many countries as possible, highlighted by aggressively funding African infrastructure development (One Belt One Road). Through China, Southern Asia (including India), Russia, and Africa, Xi has a large enough audience (about half of the world's population) to challenge the dollar.

Why it will happen

Despite foreign leaders' complaints, there are three primary reasons for the dollar's dominance (which then compounded due to the network effects of liquidity), in no particular order, as they are all intertwined:

- The US has the strongest economy (US equities/bonds are priced in dollars)
- Oil is priced in dollars
- The US has the strongest military

The next decade (2020 – 2030) will comprise of three stories that bode the decline of the dollar's dominance:

1. China will continue to grow at a higher rate than the US, surpassing the US in GDP.
2. Sustainable electricity will gradually replace oil as the world's primary energy source.
    - Note: Requiring the Saudis to price oil in the dollar ensured that every country, every entity that needed energy, also held dollars. The Saudi's are finally IPOing the most profitable company in the world for liquidity, so that they can diversify away from oil. Biotechnology will continue to eat at the other parts of the oil barrel (gasoline is just one of the useful derivatives of petroleum). This will be accelerated by the electric car movement, as once oil companies begin making less money off gas sales, they'll have to upcharge for the other petroleum derivatives, as they can't create only certain parts of the oil barrel. It will be one large, gradual and then sudden, feedback loop that ultimately kills demand for oil.
3. Wars are becoming increasingly digital, where the US's lead is marginal, if there is one at all. While physical wars may not be dead forever, they will likely continue to downtrend.

Xi knows all of this.

Why Xi likes blockchains

There are three reasons why Xi will move the RMB onto the blockchain:

- Swift, the current international payment network, is essentially controlled by the West. It's headquartered in Brussels, but what the US says goes. It's how the US sanctions whoever the US wants to sanction. Blockchains are Xi's best hope of replacing Swift. Xi is not alone here. Even the EU is talking about digitizing the Euro, so that they do not rely on Swift.
    - Note: if blockchains successfully replace Swift, American sanctions will still be meaningful due to the negative effects of not being able to do business with American companies. However, once China's GDP is the largest, especially if they can collude with Russia, India, and parts of Africa, China's sanctions could mean significantly more than America's. Moving away from Swift is the first step for Xi towards this future.
- Putting the RMB on the blockchain gives Xi more control of the RMB: he will be able to better audit past transactions and instantaneously change the RMB's inflation rate. This may sound trivial, but it's actually very meaningful: the past will be easier to evaluate, and the future will be easier to control.
- Transactions on blockchains will be faster and more secure than alternative payment rails.

While Xi absolutely wishes for China's cryptocurrency (PBOC coin) to become the global reserve currency, the RMB will likely not replace the dollar. There will be significant friction to changing the global reserve currency, and thus the benefits of doing so will need to be of an order of magnitude. The only way the RMB alone becomes an order of magnitude better than the dollar to any country is if that country is at war with the US.

The more likely solutions, which Xi likely recognizes, are either a basket of fiat currencies issued on the blockchain (i.e. Libra) or a digital gold product (i.e. Bitcoin, Ethereum). Both remove the single source of dependency from the system, which qualifies as an improvement of order of magnitude: for the first time since the termination of Bretton Woods (1971), there will be no single source of failure in the global economy. While we have no idea how much Xi actually loves Bitcoin or Ethereum, the saying 'an enemy of the enemy is a friend' rings true.

Why digital gold instead of physical gold?

Physical gold is priced in dollars. Cryptocurrency markets are localized. Physical gold is going to be further controlled and inflated by the US as the US begins mining asteroids that have a billion+ times more gold than Earth. There's already a NASA mission scheduled to land on one in 2026. Cryptocurrency mining (through both proof of work and proof of stake) already relies heavily on China (Chinese mining pools conduct over half of Bitcoin's mining.).

Digital gold is better for China, and it's a better gold for mainstream users. Digital gold's inflation rate (or lack thereof) can be finely controlled, as the digital world is more programmable than the physical. Digital gold can be feasibly used for payments, whereas moving physical gold is expensive and timely. Lastly, digital gold is easier to protect against adversaries, typically corrupt governments in the developing world (i.e. Venezuela). You can sneak digital gold across borders, through metal detectors, etc.—all you need to remember is a twelve-word mnemonic. This last point may not seem pertinent to those in the first world, but the US is not exempt from the seizure of citizens' gold (see the 1934 Gold Reserve Act).

Last words

Xi's and China's success is based on Xi's ability to understand trends, and to implement them quickly. His motion for China to lead the blockchain industry is just that. The internet will assume the function of value transfer through permissioned and permissionless blockchain networks. For the first time in the internet era, payment rails will be decentralized, not controlled by any corporation but baked into the internet protocol itself. In turn, the internet will add another feature to its operating system of productivity, further reducing the trust needed for marketplace interaction. Consequently, an increasing number of people will work remotely, causing residency (of both corporations and individuals) to become an increasingly fluid term. It will be fascinating to watch how the growth of decentralization combats the growth of populism in the US, China, and all the countries in between.