



Blockchain and the Austrian School

Max Rangeley

“The root and source of all monetary evil is the government’s monopoly on money.”
Friedrich Hayek (1976)

The European Parliament Blockchain Summit 2016

- ✓ Attendees included IMF, OECD, World Bank, United Nations, Bank for International Settlements and Europol
- ✓ OECD, IMF and other experts recognize that blockchain is delivering profound innovations and to stifle it would be harmful to the wider economy
- ✓ Europol and OECD kindly wrote papers for the Cobden Centre
- ✓ When money can be created privately, control over monetary policy instruments is, at least to some degree, ceded to the private sector



Introduction

- ✓ Very few economists would now propose a government monopoly on smartphones, cars or airlines
- ✓ How will future generations feel about a government monopoly on money?
- ✓ “There is no answer in the available literature to the question why a government monopoly of the provision of money is universally regarded as indispensable. ... It has the defects of all monopolies.” (Hayek, 1976)



Introduction

- ✓ Austrian School –
- ✓ subjective theory of value (Carl Menger)
- ✓ opportunity cost (von Wieser)
- ✓ capital and interest (von Bohm Bawerk)
- ✓ business cycle theory (von Mises)
- ✓ private money creation (Hayek)



Introduction (continued)

- ✓ Setting of interest rates by central banks distorts the economy (Hayek, 1974 Nobel Prize) – including price inflation and even more damaging capital structure distortions
- ✓ The power of central banks to manipulate interest rates rests on the creation of money
- ✓ Just as prices in other sectors of the economy should not be set by committees of economists, neither should interest rates
- ✓ Central banks are now looking at how to absorb ideas from the monetary entrepreneurs



The First Free Market in Money of the Modern Age

- ✓ Digital gold
- ✓ Grid coin
- ✓ Stanford University's Folding@home program CureCoin
- ✓ The concept of "moneyness"
- ✓ "You can put all kinds of extremely advanced terms and conditions on a digital account for money: where, when and who can spend it, and how much I can spend. That can happen with a bank account on a digital ledger." (Charles Hoskinson, blockchain company IOHK)
- ✓ "The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design." (Hayek, 1976)

Hayek-Mises Business Cycle Theory

- ✓ At the core of the Austrian Business Cycle Theory lies the idea that when central banks set interest rates they distort the economy
- ✓ Bureaucratic price setting has failed in every other sector in which it has been attempted, from food to fuel to consumer goods
- ✓ When interest rates are set too low it results in more credit being created than is justified by the amount of savings in the economy (Hayek, 1931)
- ✓ This results in a distortion of the time preferences of the economy (Garrison, 2001)
- ✓ The capital structure of the economy molds itself around the false price signals
- ✓ Private money creation will allow a move away from an economy in which bubbles are systematically created by central bank monetary policy

Hayek-Mises Business Cycle Theory (continued)

- ✓ If interest rates are allowed to be set by the demand and supply functions of the free market pricing mechanism rather than a central bank, then time preferences can become re-coordinated and can function as normal
- ✓ With the development of blockchain, there will increasingly be alternative money and credit markets
- ✓ A weakening of the monetary policy instruments available to central banks
- ✓ From the perspective of Hayek-Mises business cycle theory, it is allowing interest rates to be set by the free market which will bring about economic recovery

Hayek-Mises Business Cycle Theory: The Current Bubble

- ✓ Interest rates falling from early 1980s
- ✓ Dot com boom, “Greenspan Put”
- ✓ Housing bubble – 1% interest rates
- ✓ Following 2008 we have 0% interest rates, QE and event negative interest rates
- ✓ In 2007 there was \$150tn of global aggregate debt, now after a decade of ZIRP it is more than \$250tn
- ✓ This is a classic “Austrian” bubble built up over an entire generation.

Hayek-Mises Business Cycle Theory and Blockchain

- ✓ “More generally, in an economy with a high share of virtual currencies, the ability of monetary policy to manage the business cycle could be diminished. Some of the challenges would be similar to those faced by countries that are heavily dollarized. The current generation of virtual currencies does not allow for an expansion of the money supply in response to negative demand shocks. This would tend to exacerbate recessions and could lead to a deflationary spiral, as during the Great Depression under the gold standard.” (IMF, 2016)

Hayek-Mises Business Cycle Theory and Blockchain (continued)

- ✓ “Algorithmic digital currencies such as bitcoin appear to be viable competitors to central bank fiat currency, and their presence in the marketplace may pressure central banks to pursue tighter monetary policy.” (Raskin and Yermack, NBER, 2016)
- ✓ “In this regard, a widespread substitution of central bank money by privately issued virtual currency could significantly reduce the size of central banks’ balance sheets, and thus also their ability to influence the short-term interest rates. Central banks would need to look at their existing tools to deal with this risk (for instance, trying to impose minimum reserve requirements on virtual currency schemes).” (ECB, 2012)

Cantillon Effects

- ✓ Richard Cantillon
- ✓ French Royal Court
- ✓ Financial sector and hedge funds
- ✓ Knight Frank art prices risen by 252% in a decade, classic car values up by 487%
- ✓ ECB bond buying program





The New Monetary Irredentism: The Central Banks and Blockchain

- ✓ “These questions do not have easy answers. That is why work on central bank-issued digital currencies forms a core part of the Bank’s current research agenda (Bank of England (2015)). Although the hurdles to implementation are high, so too is the potential prize if the zero lower bound constraint could be slackened. Perhaps central bank money is ripe for its own great technological leap forward, prompted by the pressing demands of the zero lower bound.” (Andrew Haldane, 2015)
- ✓ “The only way to avoid being driven by continuing inflation into a controlled and directed economy, and therefore ultimately in order to save civilisation, will be to deprive governments of their power over the supply of money” (Hayek, 1976)



The New Monetary Irredentism: The Central Banks and Blockchain (continued)

- ✓ Relates to Charles Hoskinson idea about certain types of transactions being programmed into the money itself
- ✓ “Future of Money” conference in Frankfurt, this was one of the most discussed concepts.
- ✓ When current bubble bursts, negative interest rates will be necessary to perpetuate it.



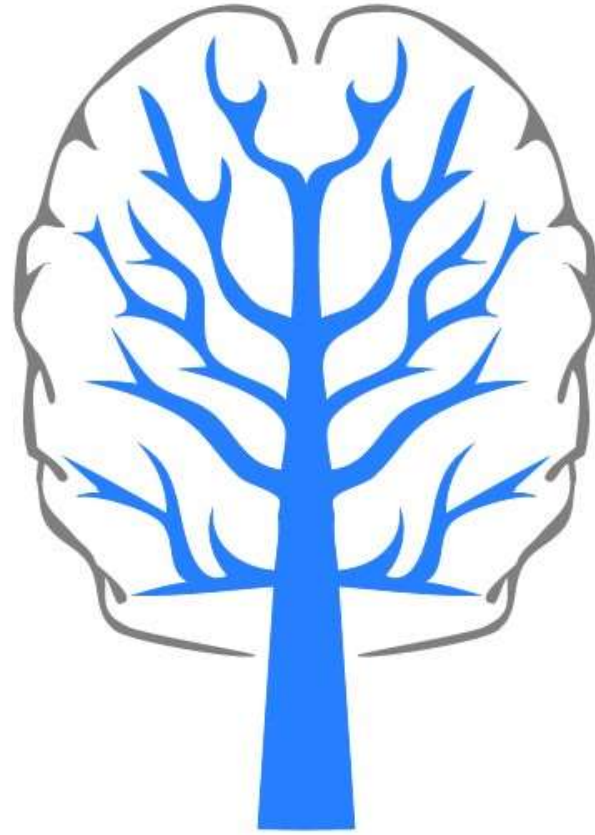
The New Monetary Irredentism: The Central Banks and Blockchain (continued)

- ✓ The implementation of negative interest rates represents an inversion of the natural laws and praxeological foundations which govern economic interactions
- ✓ The suppression of market pricing mechanisms to the point where interest rates are purely a function of what monetary central planners deem to be “optimal”
- ✓ The key mechanism that the market will have against central banks will be private currencies and private trading networks using blockchain and other related technologies wherein free market interest rates can emerge from market processes



Conclusion

- ✓ Austrian School allows us to understand current developments more than other schools
- ✓ Blockchain is already bringing about a renaissance of the Austrian School
- ✓ Central bank use of blockchain will allow hitherto unimagined forms of control
- ✓ The most reliable way to achieve sound money is—like in other areas of the economy—through competition



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