



Chapter 4 Banking Reading Is Cryptocurrency Money?

Name _____
Class _____

Cryptocurrency, or crypto, seems to be in the news a lot lately. Cryptocurrency was touted by its proponents as an opportunity to get in on the ground floor of the next big thing. Yet early on, most financial professionals viewed crypto as, at best, a highly speculative investment. Eventually, it seemed to become mainstream. Even traditional financial planners suggested that it might be good to have a small percentage of one's investment portfolio in cryptocurrency. And then there are the names. *Cryptocurrency*. *Bitcoin*. So, what is cryptocurrency, and is it money?

Cryptocurrency is a digital asset based on blockchain technology. Bitcoin, the oldest and largest circulating cryptocurrency, first appeared in 2009. The United States had just endured a major financial crisis. Several major private financial institutions went bankrupt, and the federal government had to step in to rescue others. The idea of a new financial asset that could function outside of existing financial institutions had its appeal. Eventually, hundreds of other cryptocurrencies joined Bitcoin and investors began buying them in hopes of getting in on the next big thing. As of November 2022, there were nearly 22,000 cryptocurrencies in existence.

The rise of crypto and blockchain, the technology it is based on, are essential elements of what some call Web 3.0. Proponents believe Web 3.0 will be as disruptive as the rise of the internet and usher in a new age of decentralized finance. In this new financial ecosystem, crypto will eventually replace traditional currency for most transactions. Because it is not specific to a single country it could be used as a global currency making international transactions easier.

More people took notice of Bitcoin in 2017 when the price surged by 1000%. Though Bitcoin lost 80% of its value the following year during the first "Crypto Winter", interest in cryptocurrency was growing. By April 2021, the value of one Bitcoin had risen from about \$7,000 to over \$60,000 in a single year. The gains in some smaller cryptocurrencies were even more extraordinary. Dogecoin, originally started as a joke, was making ordinary investors millionaires. \$10,000 invested in Dogecoin on January 1, 2021, would be worth over \$1.2 million when it peaked approximately **four months** later.

Proponents touted crypto as a safe way to save, invest, and spend. In reality, it was difficult to use cryptocurrency to make everyday purchases. A few major retailers accepted Bitcoin for payment, but only through a third-party processor. Tesla briefly accepted cryptocurrency as payment for its cars, but that was short-lived. Cryptocurrency brokerages offer consumers the ability to buy, sell, and store their digital tokens. Some brokerages can convert crypto to dollars deposited to a debit card. That makes spending crypto much easier.

Stories of people making fortunes in cryptocurrency began circulating in the news and on social media, attracting new buyers. Sam Bankman Fried, the founder of the crypto brokerage FTX, was featured on the cover of *Forbes* Magazine's annual 400 wealthiest

people in the world issue. With his \$23 billion estimated net worth, he was touted as the richest 29-year-old in the world. The cover featured his quote stating, "I got involved with crypto without any idea what crypto was".

Cryptocurrency seemed to be especially popular with young men, who shared stories of getting rich quickly and quitting their day jobs. Financial publications began to cover cryptocurrencies as an alternative to traditional investments such as stocks and bonds. A November 2021 survey by the Pew Research Center found that 16% of Americans held, traded, or used cryptocurrency. Crypto was most popular among men aged 18-29, with 43% responding that they had held, traded, or used it.

Soon celebrities and professional athletes were touting crypto. The 2022 Super Bowl telecast included four crypto ads. It appeared that crypto had become mainstream. But by the summer of 2022, things had changed dramatically. The second "Crypto Winter," an extended period of falling prices, began. The value of Bitcoin dropped below \$20,000, and Dogecoin fell 90% from its May 2021 peak. Yet, the value of both coins was still higher than a few years earlier.

Then several large cryptocurrency brokerages went bankrupt or froze customer assets. Some customers lost all their money. Others were left in limbo, uncertain if they would ever recover their deposits. Somehow, billions of dollars of crypto value had disappeared as quickly as it rose. Reddit bulletin boards were filled with stories of "bros" who had lost everything or had accounts frozen. Many consumers were surprised to learn that, unlike banks or traditional brokerages, the federal government did not insure crypto brokerage deposits.

In November of 2022, FTX, who only months before had stepped in to "rescue" a failing brokerage, itself went bankrupt. Sam Bankman Fried resigned as its chief executive officer. His net worth is estimated to be zero, and he may face civil and criminal penalties. Despite this, crypto's most optimistic boosters believe crypto will replace currencies such as the dollar, euro, and yen. Others have concluded it will join a long list of speculative investments that rose rapidly and fell even faster.

Railroad stocks after the Civil War, the Florida land boom of the 1920s, and dot.com stocks of the late 1990s were all speculative investments that eventually crashed. All were long on hype but short on fundamental value, destined to become a lesson in what to avoid. Today, these are often referred to as "speculative bubbles". So is cryptocurrency money, or just another speculative bubble?

Money is characterized by three essential functions. As you read about them, think about how you use money to perform these functions.

- **store of value** - People or other entities can save money and use it later. For example, you may store money for future purchases, such as college tuition or a vehicle.
- **unit of account** - Money provides an everyday basis for prices. For example, prices are marked in a unit of account when you shop for goods or services. In

the United States, it is dollars. In Germany, it is euros. In Japan, it is the yen. Units of account allow us to plan for purchases by knowing the cost.

- **medium of exchange** - Money can easily be used to buy and sell goods and services from a wide range of sellers.

Answer the following questions based on the reading and your own knowledge.

1. Why did purchasing cryptocurrencies become popular?
2. What is a “Crypto Winter”?
3. What factors might explain why crypto is most popular among 18 to 29-year-old males?
4. Review the essential functions of money. Evaluate how cryptocurrency performs each of the three functions of money. Assign a letter grade and comments that support your assessment. For comparison, assume that the dollar gets an “A” grade in each category.
 - a. store of value
 - b. unit of account

c. medium of exchange

5. Based on your evaluations, is cryptocurrency money? Explain your reasoning.

6. Is crypto a speculative bubble? What additional information would be helpful for you to answer the question?

Extending the Learning

Should the federal government regulate cryptocurrency exchanges? If so, what types of rules or regulations should they impose?