The meteoric rise and collapse of FTX

written by Prabhat Patnaik
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FTX collapse.

The large cryptocurrency exchange FTX went out of business on November 11. Many have likened this phenomenon to the collapse of the investment banking firm Lehman Brothers during the financial crisis of 2008, believing the FTX collapse to be as important an event in the cryptocurrency world as the collapse of Lehman Brothers in the official financial system.

In fact, even before the collapse of FTX, cryptocurrency values had slumped greatly. The total value of all cryptocurrencies, which had been estimated at $2 trillion by the end of 2021, had slumped to half that figure by the end of September 2022. The FTX collapse will certainly deal a further blow to this entire system.

FTX was set up by Sam Bankman-Fried, a student of Massachusetts Institute of Technology, in 2019 as a cryptocurrency exchange that exchanged one cryptocurrency for another or a cryptocurrency for fiat money and vice-versa.

In addition, it also issued its own cryptocurrency called FTT, exchanged spot fiat money or cryptocurrency for futures, and sold derivatives and options. It, thus, functioned in many ways as a bank, accepting dollars or euros or cryptocurrency today against the promise to pay larger amounts tomorrow or the day after. It had such a phenomenal rate of growth that within a mere three years, it had grown to become the fifth-largest cryptocurrency exchange by trade volume and the second-largest by holdings.

This meteoric rise was facilitated by the extraordinarily high profile that FTX acquired through a number of measures it adopted: its political donations to the Democratic Party were the highest among all donors if we leave aside George Soros. It sponsored sporting events and generally close association with several prominent sportspersons like Shaquille O'Neal, the former basketball star, and Naomi Osaka, the current tennis star. And It prominently supported the Ukraine government through the launch of an "Aid for Ukraine" program that accepted cryptocurrency donations with the promise that they would be converted into fiat money deposits with the National Bank of Kiev.

FTX’s collapse, however, has been as sudden and dramatic as its emergence. A substantial amount of its own digital currency, the FTT, was held by a firm called Alameda, which also was owned by Sam Bankman-Fried, the head of FTX. When Alameda’s balance sheet leaked out, a panic developed that a chance fall in the price of FTT would cause a major collapse in it. A rival cryptocurrency platform, Binance, started selling off its FTT holdings because of this panic, and that started a real collapse exactly in the same manner as a bank run does.

In fact, the scenario exactly resembled a bank collapse, and the reason, too, was exactly the same, namely, the absence of adequate reserves or readily saleable assets with which a sudden run could be countered. In effect, Sam Bankman-Fried was running a Ponzi scheme, siphoning off funds in a clandestine manner.

Binance, for a while, thought of buying up FTX but finally decided against it. There was, of course, no question of appealing to the government to bail out FTX, despite its closeness to the Democratic Party and President Joe Biden, since the whole idea of a cryptocurrency is to shun government scrutiny. As a result, there was no alternative to a declaration of bankruptcy, which Sam Bankman-Fried did on November 11.

This is where FTX’s parallel with Lehman Brothers, notwithstanding the importance of the collapse of each in its own respective sphere, ends.

The collapse of Lehman Brothers was the outcome of the collapse of the “housing bubble” that had got built up because of euphoric expectations about its longevity on the one hand and the development of institutional arrangements that systematically camouflaged risks on the other. The fact that many investment banks held toxic assets was not just because of greed or carelessness on their part, but above all, because under the institutional arrangements that had developed, it had become difficult to know what was a toxic asset, to distinguish between a toxic and a non-toxic asset.

To call the asset price bubble a flaw of the system, as many liberal economists were to do subsequently, is not just to be wise after the event but to miss the central point that *this so-called flaw is exactly the mechanism through which neo-liberal capitalism had managed to generate a boom*. The collapse of Lehman Brothers, in other words, was a part of the very *modus operandi* of neo-liberal capitalism.

The development of cryptocurrency, however, is not part of the *modus operandi* of the system. It is an external appendage to the system itself, whose elimination would still leave the system intact. The collapse of FTX, in short, would not jolt capitalism the way the collapse of Lehman Brothers had done. Cryptocurrency is like a commodity, or more appropriately, a security, that is generated and held outside of any government supervision. In fact, therein lies its attractiveness to those who hold it, for in the shadowy world where it functions, no questions are asked about its operation.

It is not surprising that the balance sheet of Alameda, the firm also owned by Sam Bankman-Fried, and even its ownership, was unknown for a long time to the holders of FTX's cryptocurrency, the FTT. And it is also not surprising that the accounts of FTX had scarcely been properly audited, for otherwise, the shenanigans of Sam Bankman-Fried would not have gone unnoticed.

Cryptocurrency belongs to a shadowy system that has developed alongside the capitalist system from which the operators of the latter system derive great personal benefits, such as, for instance, deploying funds that are officially not accounted for; but this shadowy system is not organic to the latter's functioning. The functioning of capitalism is punctuated with fraudulent practices, but it will be a serious mistake, as Marx was at pains to point out, to treat the system merely as a fraudulent system.

It is not surprising that there has been no attempt on the part of the U.S. government to bail out FTX, as there had been to bail out the rest of the American financial system after the collapse of Lehman Brothers, for which the Obama administration had pledged $13 trillion at that time.

A system that deliberately shuns government supervision can scarcely ask for government assistance when faced with a crisis, and no government will be brazen enough to assist it when it is faced with a crisis just because its leading personnel gets substantial donations from it.

If Lehman Brothers' collapse was linked to the *modus operandi* of capitalism, FTX's collapse arises because of the fraudulent practices that can, and typically do, characterize this entire world of cryptocurrencies, practices whose prevalence is precisely what constitutes the attraction of this world for those who inhabit it.

Again, it is not surprising that questions are being raised about how much of the "Aid for Ukraine" fund was actually sent to Ukraine and to whom, and how much of it was actually used for its proclaimed purposes. When this entire program has been characterized by zero accountability and zero transparency, and when information about it has to be pieced together from disjointed comments appearing from time to time on the web page, such questions are bound to be raised. And it speaks volumes about the Ukrainian government and its Western backers that they allowed such shady outfits like FTX to raise millions of dollars in the name of helping Ukraine.

The collapse of FTX raises important questions about the future of the cryptocurrency system itself. Though many would have incurred losses because of the collapse of FTX, it is unlikely that the system would spontaneously wither away. The question really is: what kind of government policy would this collapse generate?

The Chinese government has banned cryptocurrency for quite some time now. The Indian government had also announced in 2021 that it would bring a Bill before

Parliament to ban cryptocurrency, but it has not yet done so. Given this government's softness towards fraudsters, of which the forgiving attitude toward private filching of bank funds is an obvious example, it is doubtful if such a Bill will ever be tabled; but that would be extremely unfortunate.

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