

GUEST ESSAY

The Crypto Collapse and the End of the Magical Thinking That Infected Capitalism

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By Mihir A. Desai

Mr. Desai is a professor at Harvard Business School and Harvard Law School.

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At a guest lecture at a military academy when the price of a single Bitcoin neared \$60,000, I was asked, as finance professors often are, what I thought about cryptocurrencies. Rather than respond with my usual skepticism, I polled the students. More than half of attendees had traded cryptocurrencies, often financed by loans.

I was stunned. How could this population of young people come to spend time and energy in this way? And these students were hardly alone. The appetite for crypto has been most pronounced among Gen Z and millennials. Those groups became investors in the past 15 years at previously unseen rates and with exceedingly optimistic expectations.

I have come to view cryptocurrencies not simply as exotic assets but as a manifestation of a magical thinking that had come to infect part of the generation who grew up in the aftermath of the Great Recession — and American capitalism, more broadly.

For these purposes, magical thinking is the assumption that favored conditions will continue on forever without regard for history. It is the minimizing of constraints and trade-offs in favor of techno-utopianism and the exclusive emphasis on positive outcomes and novelty. It is the conflation of virtue with commerce.

Where did this ideology come from? An exceptional period of low interest rates and excess liquidity provided the fertile soil for fantastical dreams to flourish. Pervasive consumer-facing technology allowed individuals to believe that the latest platform company or arrogant tech entrepreneur could change everything. Anger after the 2008 global financial crisis created a receptivity to radical economic solutions, and disappointment with traditional politics displaced social ambitions onto the world of commerce. The hothouse of Covid's peaks turbocharged all these impulses as we sat bored in front of screens, fueled by seemingly free money.

With Bitcoin now trading at around \$17,000, and amid declining stock valuations and tech sector layoffs, these ideas have begun to crack. The unwinding of magical thinking will dominate this decade in painful but ultimately restorative ways — and that unwinding will be most painful to the generation conditioned to believe these fantasies.

Cryptocurrency is the most ideal vessel of these impulses. A speculative asset with a tenuous underlying predetermined value provides a blank slate that meaning can be imposed onto. Crypto boosters have promised to replace governments by supplanting traditional currencies. They vowed to reject the traditional banking and financial system through decentralized finance. They said they could reject the purported stranglehold of internet giants on commerce through something called Web 3.0. They insisted we could reject the traditional path toward success of education, savings and investment by getting in early on dogecoin, a meme coin intended as a joke that reached a peak market capitalization of over \$80 billion.

These illusory and ridiculous promises share a common anti-establishment sentiment fueled by a technology that most of us never understood. Who needs governments, banks, the traditional internet or homespun wisdom when we can operate above and beyond?

Mainstream financial markets came to manifest these same tendencies, as magical thinking pervaded the wider investor class. During a period of declining and zero interest rates, mistakes and mediocrities were obscured or forgiven, while speculative assets with low probabilities of far-off success inflated in value enormously. Hawkers pitching shiny new vehicles — like “stablecoins” that purportedly transformed speculative assets into stable ones and novel ways of taking companies public without typical regulatory scrutiny — promised greater returns while dismissing greater risks, a hallmark of the ignorance of trade-offs in magical thinking. For an extended period, many investors bought the equivalent of lottery tickets. And many won.

The real economy could not escape infection. Companies flourished by inflating their scope and ambition to feed the desire for magical thinking. WeWork, a mundane business that provided flexible work spaces, was portrayed as a spiritual enterprise that would remake the human condition. Its valuation soared, obscuring the questionable activities of its founders. Facebook and Google reconceived themselves as technological powerhouses, rebranding as Meta and Alphabet, respectively. They sought broad capabilities that they could flex at will in the metaverse or with their “moonshot projects” when, in fact, they are prosaic (if extremely effective) advertising businesses. They are now struggling with many of their fantastical efforts.

Most broadly, many corporations have come to embrace broader social missions in response to the desire of younger investors and employees to use their capital and employment as instruments for social change. Another manifestation of magical thinking is believing that the best hope for progress on our greatest challenges — climate change, racial injustice and economic inequality — are corporations and individual investment and consumption choices, rather than political mobilization and our communities.

I confess that this screed reflects my own experience. For the past decade, being a finance professor meant being asked about crypto or about novel valuation methods for unprofitable companies — and being smiled at (and ignored) when I would counter with traditional instincts. Every business problem, I am told, can be solved in radically new and effective ways by applying artificial intelligence to ever-increasing amounts of data with a dash of design thinking. Many graduates coming of age in this period of financial giddiness and widening corporate ambition have been taught to chase these glittery objects with their human and financial capital instead of investing in sustainable paths — a habit that will be harder to instill at later ages.

Embracing novelty and ambition in the face of huge problems is to be lauded, but the unhinged variety of these admirable traits that we have seen so much of in recent years is counterproductive. The fundamentals of business have not changed merely because of new technologies or low interest rates. The way to prosper is still by solving problems in new ways that sustainably deliver value to employees, capital providers and customers. Over-promising the scope of change created by technology and the possibilities of business and finance to a new generation will lead only to disaffection as these promises falter. All those new investors and crypto owners may nurse a grudge against capitalism, rather than understand the perverse world they were born into.

The end of magical thinking is upon us as cryptocurrencies and valuations are collapsing — and that is good news. Vested interests will resist that trend by continuing to propagate fictions. But rising rates and a return to more routine business cycles will continue to provide the rude awakening that began in 2022.

What comes next? Hopefully, a revitalization of that great American tradition of pragmatism will follow. Speculative assets without any economic function should be worth nothing. Existing institutions, flawed as they are, should be improved upon rather than being displaced. Risk and return are inevitably linked.

Corporations are valuable socially because they solve problems and generate wealth. But they should not be trusted as arbiters of progress and should be balanced by a state that mediates political questions. Trade-offs are everywhere and inescapable. Navigating these trade-offs, rather than ignoring them, is the recipe for a good life.

Mihir A. Desai is a professor at Harvard Business School and Harvard Law School and the author of "How Finance Works and The Wisdom of Finance."

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