

In the absence of a guarantor, a lender will typically look for collateral, which is something of similar value to the loan, but not liquid enough to convert to cash today (or else you wouldn't need the loan). Examples here would be assets held in trusts that have difficult restrictions or tax consequences, like retirement accounts, or hard assets, like property or gold. In some cases, you might use the equipment your business needs to operate as collateral. Bitcoin mining companies famously used their miners as collateral, causing widespread bankruptcies in 2022, when the values of the miners dropped at the same time as the dollar value of bitcoin.

When a borrower uses collateral, they are typically required to hold a minimum value relative to the overall value of the loan (called the loan-to-value or LTV ratio). When that minimum value is breached, the borrower is required to make up the difference by pledging more collateral or else risk defaulting on their loan and having their collateral liquidated by the lender. This is the story of virtually every market crash going back to Sumeria, and was the central theme of the 2008 global financial crisis, the 2022 BoE pension bailout, and the March 2023 banking crisis.

12.2 Collateral Before Bitcoin: Exacerbation of Booms and Busts

The inflationary dynamic that makes it more advantageous to be a borrower than a lender creates a perverted incentive at