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What Are Tokenomics?



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This article aims to provide an overview of Tokenomics in cryptocurrency. It references supply and demand, methods of token distribution, and monetary models. If you are unfamiliar with crypto, read our articles on [blockchain](#), [crypto](#), and [DeFi](#) before reading this article.

What Are Tokenomics?

“Tokenomics” is a blend word from “token” and “economics”. Fundamentally, tokenomics consists of understanding the supply and demand characteristics of tokens. Key aspects of tokens that give investors a more profound understanding are functionality, purpose, and distribution.

Tokens are a central part of the crypto world. They represent digital units of value on a blockchain, with a wide range of use cases such as governance, utility, and security.





would, in most cases, require a majority vote from the token holders.

How Are Key Metrics Measured?

Total supply of tokens: This is the maximum number of tokens that a project can issue. For instance, Ethereum (ETH) has no maximum supply of tokens compared to Bitcoin (BTC) which will only have a maximum of 21 million in circulation.

This refers to the total number of tokens that have been issued to date.

This refers to the token price multiplied by the circulating supply of tokens.

This refers to the token price multiplied by the total supply of tokens to ever exist.

How Are Tokens Distributed?

There are different ways projects approach the launch of their tokens. This allocation and distribution amongst founding teams, users, and funding partners largely depends on the project's vision and goals.

This is when a project does not provide token allocations to early access users, founding teams, or investors.

For pre-mine launches, developers mine a certain number of tokens in advance to allocate to founding teams and funding partners. These two parties are usually allocated tokens with a vesting schedule. Vesting schedules are a mechanism to avoid immediate dumping of tokens on the market, which could lead to high levels of volatility.

Monetary Models

1. Inflationary

An inflationary token model will continue to print more tokens over time, with no limit on the maximum token supply. This model bears a close resemblance to fiat currencies, such as the





2. Deflationary

In this type of model, a project sets a definite limit on the number of tokens that can be ever created. BTC has a deflationary model due to its 21 million token cap. There is also a fall in the production rate of BTC every four years, popularly known as the Bitcoin halving. This limited supply could create a natural demand for the token, eliminating inflation woes.

3. Dual-token

A single blockchain uses two distinct tokens in a dual-token model to construct a better economic structure. A project would use one token for financial value and the other for utility purposes. Generally, this is done to keep the worlds of utility and financial incentives separate. An example of this model is MakerDAO, which has two tokens. In the MakerDAO ecosystem, Maker (MKR) token acts as a governance token, whereas DAI is the native stablecoin pegged to the USD.

4. Asset-backed

Tokens that follow the asset-backed model derive their value from the underlying asset that they are backed by, usually the USD. Tokens such as BUSD, USDT, and USDC are popular examples of tokens whose value is pegged against the US Dollar.

Incentivization

Tokens have a more significant impact when the end-user directly benefits from using them. To better understand with an example, let us look at [Arweave](#). It seeks to solve the problem of permanent data storage through acting as a collectively owned hard drive of information. By connecting users with free hard drive space to others who need storage options, it can derive value and utility for its users. To get started, users can claim an amount of Arweave token (AR) along with a wallet for free. Getting users to begin using their platform by providing incentivization at the start is a popular way of generating interest.

There is also a differentiation between governance and utility tokens. A protocol can incentivize users to participate in their ecosystem by issuing governance tokens, which represent voting power in the project. Users are able to use these governance tokens to create and vote on various proposals. Utility tokens are digital assets with specific use cases in a protocol's ecosystem. For example, BNB token helps users offset trading fees within the Binance trading platform. BAT (Basic Attention Token) is the native token of the Brave browser and it helps to distribute advertising money equally between users, creators and advertisers.

Combating Inflation





Ethereum Improvement Proposal (EIP) 1559 is a popular example of a burn process. In an attempt to increase the mining speed of new ETH and incentivize it, [EIP-1559 has burned over USD 5.7 billion worth of ETH](#) since its launch in August 2021. Its objective is to reduce the supply of ETH and possibly boost the asset's price due to the reduction in supply.

The Future of the Token Economy

Tokenomics is a valuable tool to analyze the economic strength of a project, but it should not be considered in isolation. Factors such as community, active development, proposals, and the core team's credibility, not to mention sector-specific conditions, are also essential to consider before investing in a project.

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