

Bitcoin is a Bubble. Blockchain is a Breakthrough

By Stephen Slifer Thu, Dec 7, 2017

'Bitcoins are only useful to speculators, but the blockchain technology on which it is based will both enhance cyber-security and make the current payment mechanism far more efficient,' writes our guest columnist, publisher of the NumberNomics blog.



Bitcoin is new and exciting. But bitcoin was developed in secrecy by a person or group of people whose identity remains unknown. Its whole purpose is to evade regulation which makes it particularly appealing to the darker side of society—drug dealers, arm sales, terrorists, sex traffickers—which gives it a close link to tax evasion and organized crime.

While it is being billed as “money,” it is not. It is neither a medium of exchange nor a store of value. Bitcoin purchasers today are doing so solely because they seek the anonymity or because they believe the value of a bitcoin will be higher tomorrow. Thus, it seems to us that bitcoin is more like a tulip than money and does not serve any socially useful economic function.

Having said that, the underlying technology on which it is based is revolutionary and could make identity theft by hackers far more difficult, and eventually eliminate the 2-3% transaction fee typically charged today on credit card transactions. It is important to distinguish between bitcoins and the technological advancement that was used to create it. One is useful, one is not.

The origination of the bitcoin is shrouded in secrecy. It was developed in 2008 by some person or a group of people, using a pseudonym—Satoshi Nakamoto—whose identity remains unknown. That is hardly a confidence-boosting start.

Bitcoins are being billed as a new form of “money.” But money is supposed to be a “medium of exchange” which means that it is a widely accepted means of payment. However, few legitimate businesses today accept bitcoin as a means of payment. Money is also supposed to be a “store of value”. But the value of a bitcoin is wildly unstable and its value can change by 10% or more in a single day. It is hard to imagine any investor choosing to park a large portion of his or her assets in bitcoins given this extreme volatility. Thus, bitcoins do not fit any conventional definition of “money”.

The appeal of bitcoin is that the technology on which it is based makes transactions largely anonymous which explains bitcoin’s appeal to the darker side of society. Most illegal activities from drug and gun sales to prostitution and the sex trade are done in cash. But money laundering is challenging, and bitcoins offer the perfect opportunity to convert a mountain of cash into a useable form without alerting authorities.

But the illegal nature of these transactions is sure to encourage regulators to keep a watchful eye on the

market and could lead them to impose regulations which would dampen its appeal. It is also going to attract the attention of crime-busters like the FBI. Silk Road was an online black market best known as a platform for selling illegal drugs. It was shut down by the FBI in 2013 but, unfortunately, many Silk Road look-alikes have emerged.

While recognizing the downside of bitcoin, the blockchain technology on which it is based is revolutionary. In today's world transactions are cleared by banks which verify that the purchaser has the funds available and transfer the proceeds to someone else's account. Thus, transactions are controlled by banks. But blockchain can be thought of as a giant private sector database that performs those transactions without the bank or any other central authority.

Once a transaction is recorded the bitcoin network it is encrypted by a formula that can supposedly be unlocked only through a trial-and-error process and eventually the bitcoin proceeds find their way to the seller. The transaction is both anonymous and cost-less. Those are powerful advantages.

As a result, central banks around the world are working feverishly to determine whether adoption of blockchain technology could make it harder for hackers to engage in identity theft. Furthermore, in today's world a merchant pays a 2-3% fee when a purchaser uses a credit card. Bitcoin technology could eliminate these fees to the middleman. Thus, bitcoin technology offers the opportunity to advance the financial payments mechanism into the 21st century.

As we see it, bitcoins have no socially useful economic function. They are not money and they facilitate the ability of drug dealers, gun sellers, sex traffickers, and terrorists to finance their operations. Bitcoins are only useful to speculators—hedge funds and high-speed trading firms in particular. For these reasons, in our opinion, bitcoin has limited appeal. But the blockchain technology on which it is based is revolutionary and will both enhance cyber-security and make the current payment mechanism far more efficient.