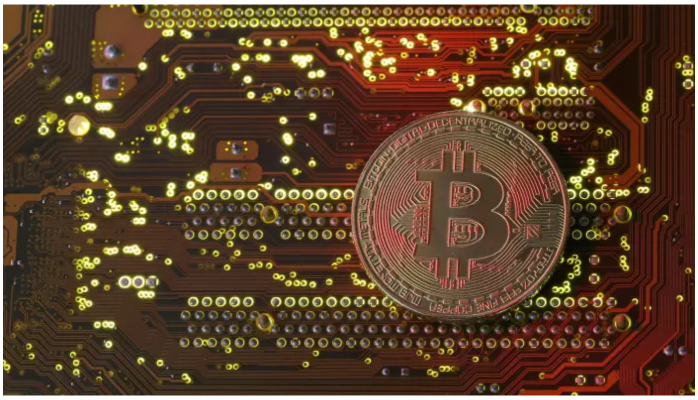
Opinion **Bitcoin**

There are many reasons to be cautious about bitcoin

The craze for initial coin offerings ignores financial fundamentals

JEAN TIROLE



Bitcoin is a pure bubble, an asset without intrinsic value — its price will fall to zero if trust vanishes © Reuters

YESTERDAY Jean Tirole

The current craze for cryptocurrencies seems boundless. The dollar value of bitcoin has been multiplied by 10 since the beginning of the year, and by 30,000 since January 1 2011. "Initial coin offerings", through which companies finance themselves by issuing "tokens" (cryptocurrencies newly minted for the occasion), have raised $3.5bn so far this year. We should be cautious of this trend: investors must be protected and regulated banks, insurance companies and pension funds should be prevented from building exposures to these instruments.

My scepticism does not concern blockchain, the technology behind bitcoin. This distributed ledger technology is a welcome innovation with useful applications, including fast, automatic execution of smart contracts. What worries me are the cryptocurrencies themselves. Bitcoin raises two distinct questions. Is it sustainable? And assuming it is, does it contribute to the common good? My answers are: probably not (the jury is still out) and definitely not.

On the sustainability question, bitcoin is a pure bubble, an asset without intrinsic value — its price will fall to zero if trust vanishes. There are undeniably certain successful, long-lasting, bubbles: gold (whose value vastly exceeds the price that it would fetch if it were treated as a raw material and used for industrial or decorative purposes); or even the dollar, the pound or the euro. The history of markets, though, is littered with bubbles ending in crashes, from Dutch tulip bulbs in the 1630s and the South Sea bubble in 1720, to countless stock market and real estate bubbles. No one can say with certainty that bitcoin will crash. It could become the new gold. But I would not bet my savings on it, nor would I want regulated banks to gamble on its value.

Bitcoin's social value is rather elusive to me. Consider seigniorage: an expansion in the money supply traditionally provides the government with extra resources. As it should, the proceeds of issuance should go to the community. In the case of bitcoin, the first minted coins went into private hands. Newly minted coins create the equivalent of a wasteful arm's race. "Mining pools" compete to obtain bitcoins by investing in computing power and spending on electricity. There goes the seigniorage.

Bitcoin may be a libertarian dream, but it is a real headache for anyone who views public policy as a necessary complement to market economies. It is still too often used for tax evasion or money laundering. And how would central banks run countercyclical policies in a world of private cryptocurrencies?

The ICO craze is no more reassuring. Heralded as liberation from the power of financial intermediaries, from venture capital to banks, it neglects the fundamentals of finance: the use of trusted and well-capitalised intermediaries to monitor projects.

Centuries of experience have taught us the value of screening out fraudulent or low-value projects and of exercising voice in corporate governance. Screening and monitoring are "public goods" from the point of view of investors; freeriding makes their supply unlikely under most forms of ICOs.

To finance ICO projects, backers issue and hand over “tokens” to investors. These are often compared to shares, but unlike stocks, they most often confer no voting rights. Furthermore, if the distribution of dividends is in tokens rather than, say, dollars, tokens are again pure bubbles, and their value can fall to zero regardless of the company’s success.

Technological advances can and will improve the efficiency of financial transactions. But they should not lead us to abstract from economic fundamentals. Governments that still give sympathetic consideration to bitcoin and ICOs would be well-advised to protect their citizens and their financial institutions against risky and socially harmful developments.

The writer is chairman of Toulouse School of Economics and author of ‘Economics for the Common Good’