CATO Monetary Conference: Economist Tells World to Sell Their Bitcoins

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NEW YORK (InsideBitcoins) — Kevin Dowd is a professor of finance and economics at Durham University, and one of his main areas of research over the years has been the topic of private money. For this reason, it seems clear that Dowd would have a fascination with bitcoin.

"In spite of its success today, bitcoin is not sustainable. It will collapse."

In a recent presentation at the Cato Institute's 32nd Annual Monetary Conference, Dowd confessed that he wished bitcoin were a solution for private money. On the other hand, he also pointed out what he perceived to be many flaws with the digital scarce resource. It is due to these proposed flaws that Dowd has a bearish outlook on bitcoin as a currency.

A system of distributed trust

To his credit, Dowd seems to understand bitcoin's main value proposition, which is its system of distributed trust. As long as decentralization can be maintained in the bitcoin system, it seems that Dowd would find it to be a valuable alternative to other forms of money. He even pointed out that the tamper-proof mechanism for the creation of new bitcoins should be viewed as an attractive benefit of such a system.

Having said that, Dowd does not believe that bitcoin can maintain this system of distributed trust over the long term.

Distributed trust is lost if mining is centralized

Dowd sees bitcoin's current incentive structure leading to an inevitable collapse, mostly due to the centralization of mining. He sees this centralization eventually leading to a natural monopoly. Dowd noted the economies of scale in bitcoin where it makes sense for multiple miners to join together instead of working against each other.

When you take this concept to its eventual conclusion, Dowd believes that it makes sense for all miners to come together to form one, centralized bitcoin mining institution This would effectively destroy the decentralization of bitcoin, which also removes its value proposition.

Is Kevin Dowd right?

The criticism of mining centralization in bitcoin is not a new one, but it is one of the few criticisms that actually has some merit to it. While there is no doubt that more work could be done to improve the decentralization of bitcoin mining over the long term, the incentive structure seems good enough for now.

The main flaw in Dowd's presentation is that he ignores the fact that miners who decide to centralize the mining process are also hurting the value proposition of the very resource they are mining. Although it may make sense to combine forces at first glance, the fact that doing so would hurt the value proposition of bitcoin must be taken into account. We've already seen various powerful mining pools, such as Ghash.io and BTC Guild, voluntary limit their share of the network hashrate to help maintain bitcoin's value proposition.

Note: There were some other statements made by Dowd that seem absurd to any bitcoin supporter at first. For example, he claims bitcoin is inefficient because this sort of transaction system could exist on a single server, and he says PayPal is a more reputable option than Ghash. These statements become less absurd when remembering that he doesn't believe bitcoin will be able to maintain its system of decentralized trust.

For what it's worth, this is one of the most legitimate criticisms of bitcoin that I've seen from an economist.