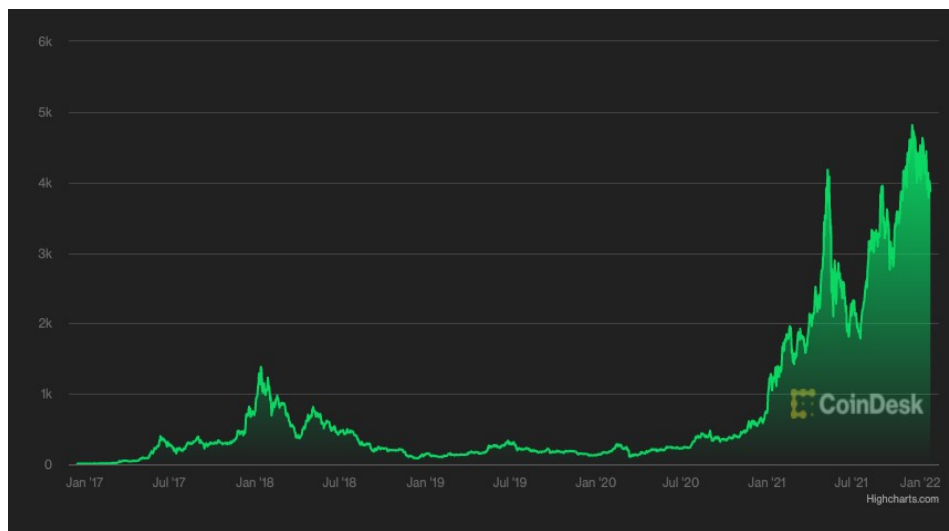


NFT Problems

by Paul Slocum (rev 0.915)

At the beginning of last year, the general public's association with cryptocurrency was with things like the Silk Road drug market, ransomware attacks, sketchy investments, computer nerds playing with fake money. That started to change last February when Elon Musk announced his investment of \$1.5b in Bitcoin. To some this still just seemed like video game money, but then the following month the record breaking \$69m Beeple sale at Christie's became worldwide news, and since then a large swath of the art world has engaged with NFTs and crypto from artists to galleries to publications to museums, giving cryptocurrency legitimacy and a sense of cultural sophistication. Crypto traders who were previously speculating on the thousands of available crypto coins could now switch to NFTs and designate themselves curators and collectors. There's a significant amount of money and power involved, so I wanted to take a closer look at some of the potential problems with this technology that the art world and others are backing.



Value of Ethereum over the last 5 years

Cryptocurrencies and blockchain technology are at the core of all these related concepts like NFTs, web3, and DAOs. Both the art world and the software world have divided opinions about crypto, but most people agree that blockchain technology is very effective at marketing. Blockchain explanations read like science fiction actualized, and it's compelling and understandable on a high level even without a lot of technical knowledge. People are drawn in by the sense of intricate unbreakable security, redundancy, and community action.

However while the claims about blockchain technology itself are generally true, the actual marketing you see often conflates different contexts such that the claims are no longer quite accurate. And once a person has taken the time to try to understand the blockchain, cryptocurrency, NFTs, and who Beeple is, it's so much information overload that it's easy to miss some subtle logical problems and political implications hidden within, even for people with software development experience. Some of the marketing is quite aggressive too, like how "web3" is falsely conveying the idea that it arrived from some consensus in the software industry when it's primarily just a marketing term from the crypto industry.

In this essay I break down various marketing claims and practical functions of crypto and NFTs to examine where they may succeed or fail.

Art Authentication and Decentralization

Suppose somebody downloads an artist's work off their website and sells forgery NFTs. Then later, the artist makes and sells legitimate versions of those NFTs. Using only the blockchain, how do you know which one is authentic? The blockchain in fact cannot know whether any NFT is a forgery or not without referring to some outside trusted service that has authenticated the artist and artworks. This is often referred to as [the oracle problem](#). Artwork is [plagiarized and sold as NFTs](#) all the time, and artists are starting to realize the need for a centralized service that validates artists and artworks. Also, without a separate centralized authentication layer on top of the blockchain, there is no way to reissue NFTs in the case of theft or to invalidate them in the case of hacked artist accounts. And if you need a centralized authentication service, the system as a whole is no longer decentralized, and one could conceivably do art authentication more simply and efficiently without the blockchain at all.

Some might suggest that the solution to decentralized art authentication is some kind of code-driven decentralized organization with a voting system that authenticates the art. But what about when 4chan hacks the system, or when they brigade the voting to get their counterfeit accounts declared legitimate? Once the decentralized organization works out all these problems, it is likely to arrive at the same structure you'd expect of a normal centralized art authentication service. Not everything is solved efficiently by software and public voting, as anyone who has used moderation bots can attest.

The Sale of Digital Art

It's a common misconception that NFTs solve some technical or legal problem making it possible to sell digital art, but it's really intellectual property law that allows selling art editions with certificates. In addition to artists like Cory Arcangel, Petra Cortright, and JODI who have sold digital editions with traditional certificates for many years, Rafaël Rozendaal and Miltos Manetas have been selling digital art on websites using ICANN's domain name system as an art registry since the early 2000s. And many of those artist's editions are available to view online and do not depend on artificial scarcity.

But NFTs also introduce a new problem, which is that everything is public record and many of the most dedicated and thoughtful art collectors are very private. Even if a collector uses an alias, in many cases it would be easy to eventually figure out who they are by examining ownership records. To truly hide a collector's identity, it would be necessary to have different IDs tied to different editions, which is cumbersome and creates the need for centralized structures outside the blockchain again.

It's also worth noting that NFTs are not required to sell art with a resale royalties contract. However, as an aside, I've been selling digital and physical art for 15 years, and I'm only aware of one artwork that's actually changed hands, which would have resulted in a relatively small payout for that one artist had I implemented those type of contracts. You really can only make resale money in the near term if work is flipped frequently, which is not generally desirable since the artwork is likely to end up in a random collection of speculative assets. And even in the long term it's often only artists who are already successful that truly benefit from resale royalties because they're the only ones who have significant second market sales and high enough prices for royalties to make a difference. I'm not against resale royalties, but I think they're overstated as a reliable solution to support artists.

Storage and Digital Art Conservation

It's another common misconception that the blockchain is able to store an artwork's media files in addition to the ownership registry, but this is not practical because it's extremely cost prohibitive to store data on the blockchain unless the data is very small. Most NFTs only contain a link to the artwork media that is stored elsewhere. There are some artists who make artwork stored directly on the blockchain, but since that can only work for niche artworks that have a tiny amount of data that never needs to be changed, it's not practical as a general solution for digital art storage. Digital artworks often need to be updated to maintain compatibility with modern browsers, displays, etc. Amazon and other standard web hosting solutions are often used for hosting NFT data, and there are also other decentralized technologies like [IPFS](#) which has similarities to BitTorrent's file distribution system. However, a problem with traditional web storage is that there's no way to fully validate the NFTs hosted data (what if a domain expires and is purchased by someone else?). IPFS references files by hash so it is possible to validate the files contents, but there is no way for an artist to issue a fully validated update to the artwork data. Then again, for any serious professional art registry, the data should also be backed up on other platforms and offline, so neither IPFS or traditional web hosting are a complete solution by themselves.

Another problem for conservation is the blockchain itself. The time scale of art ownership and digital conservation is long, and it's uncertain that any particular blockchain is going to still be around in a few decades. Blockchain data will probably be migrated and archived somehow, but it's unpredictable if there will still be a running blockchain that's accessible as before with the same software. At best, the blockchain certificate will require ongoing maintenance to maintain access and functionality. Part of the reason the blockchain may need to be preserved or emulated is for cases where the artwork interacts with the blockchain data. But more importantly, since the data on the blockchain is legally tied to ownership of the edition, the unknown lifespan of a blockchain introduces some complicated questions about how the work may be sold far in the future and how blockchain preservation functions in a legal sense.

As absurd as it may sound in the NFT age, I still believe the best solution is archival paper certificates with a central database, because a good paper certificate can last over a century. And unlike Bored Apes Yacht Club theft victims who [have no recourse to recover stolen work](#), I can just invalidate the old certificate in my database and mail the collector a new one whenever one of their paper certificates is lost or stolen. If paper conservation doesn't make any great advances in the next century and the certificate eventually disintegrates, then it can be replaced with digital documentation or some other placeholder. I've also considered using thin, engraved steel plates for increased longevity.

For many existing digital art collectors who are buying for the long haul, a rapid digital art trading system just isn't that important, and none of the digital art collectors I personally know have interest in NFTs. I hope to eventually pass off my database to an archive or an organization who can maintain it long-term. But if that doesn't happen and I die, then all the collectors still have the original maintenance-free physical certificates, records of purchase, and correspondence to prove ownership the old Antiques Roadshow way. If somebody someday brings a broken, decades-old laptop to Antiques Roadshow that's known to contain the key to a valuable NFT, then there's actually some chance that an old photograph of the owner with their NFT and a copy of the current newspaper would be more useful for verification than the computer.

Compatibility with Museum Collections

Buying a movie on DVD doesn't mean you can publicly screen it, because copyright law reserves the right to public performance for the copyright holder. This is enforced strictly by the film and music industries. Because of this, digital artwork certificates should give explicit permission for public exhibition in order to be fully legally compatible with museum collections, because otherwise the museum might end up unable to exhibit a purchased work until copyright expires if the artist happens to be pedantic about copyright laws or just wants to prevent the work from being shown.

United States copyright law includes an exception to public performance limitations if somebody actually owns a painting, print, or sculpture. But that doesn't automatically apply to digital media, which makes sense, because it's especially useful for a digital artist to be able to choose whether they are selling editions that are only for private use or editions that permit public use. There might be some way a museum could win in a lawsuit about publicly displayed digital work if it comes to that, but the museum would be up against the long case history of the film industry enforcing performance restrictions, so it's ideal to avoid that risk.

It's also typical for art certificates to include the rights to use images of the work for promotion of exhibitions and exhibition catalogs, and they should also ideally account for the obsolescence of the blockchain by specifying some way that ownership can be conferred if the blockchain no longer exists.

The potential incompatibilities with museum collections discussed here can be fixed by improving NFT certificates, but it is a problem for many existing NFTs. The recent Andy Warhol NFTs sold by Christie's specifically say that they are only for "personal" display, making them incompatible with museums. Feral File is the one of the few NFT platform I've found that [properly addresses these issues](#). There are some generative digital collectible NFT projects like Bored Ape Yacht Club that do actually confer full copyright, but that's a special situation made possible by the project's generative nature where each owner effectively has a diluted copyright that only covers a minor variation on a theme, and the project creators can still retain copyright of some variations for themselves. But most artists are understandably not going to want to sell full copyright of their singular artworks because their artworks could then be used to market questionable products, or the owner could even stop the artist from using images of their own work.

It also is worth mentioning that this all becomes moot once copyright expires, which is typically around 100 years in the United States. A museum could probably legally archive the available torrent that somebody made of "every NFT", store it until the copyright expires, and then exhibit the work freely after that. It would be interesting to peek into the future and see how the expiration of copyright affects the value of NFTs and other digital editions.

Artist Financial Support

A positive for many digital artists is that they're making significantly more money selling their digital work as NFTs than they did selling in the traditional art market. However, the NFT market tends to amplify digital artists who were already commercially successful or those who make work that fits well into crypto's somewhat narrow view of digital art, which leaves a lot of other digital art by the wayside. In [Artnet's recent debut "NFT" auction](#) that included historic digital artists like JODI and Vuk Ćosić, JODI's print at \$800 (0.2 ETH) went without any bids, and Ćosić's print sold for \$1000 (0.25 ETH), while Kevin and Jennifer McCoy's digital artwork sold for \$160,000 (40 ETH). Not that the McCoy's don't

deserve success, but Kevin's status as the co-creator of one of the first NFTs obviously must be playing into this conspicuous price disparity, and throughout this Artnet auction and the NFT marketplace in general, I see signs that the NFT art market values a strong connection to crypto and NFT culture far above any deeper value or connection to digital art history. It also should be noted that [JODI was not involved with this auction.](#)

Additionally, [a recent study](#) showed that only the top 1% of NFT sales are bid above \$1000, and artists in the lower 34% of sales are likely losing money on NFT sales because of fees. This suggests that NFTs are reinforcing the same kinds of disparity in the traditional art market. Among digital artists whose sales I follow, NFTs have worsened the revenue gap by a couple orders of magnitude between commercially successful digital artists and those are "successful" in press and exhibitions but barely able to sell work. While some artists are able to gain significant financial support from NFTs without compromising their art practice, the system still leaves a lot of questions about equity and sustainability.

Security

The blockchain database security system that drives cryptocurrencies and NFTs is secure; however a significant problem is that the way blockchain security is marketed and deployed creates a sense of overconfidence with developers and users. This year there were billions stolen, and nearly two crypto thefts per month each totaling over \$10m each. Developers and users who are relatively inexperienced with security rely too much on the blockchain without realizing that there are many layers and facets of security of which the core database is only a small part.

[Multiple people](#) have been tortured in their home by criminals to get their cryptocurrency. Previously there generally wasn't a good method for somebody to force a wealthy person to instantly transfer millions of dollars internationally in a way that's almost impossible to trace or reverse, but that is now possible with crypto coin shuffling services and other obfuscation techniques. Once crypto gets its act together in terms of security and consumer protection, those frictionless payments probably won't be quite as frictionless anymore, and the blockchain will only be a relatively small part of the entire security system.

The Environment

I think the severity of the energy usage problem is debatable and complex. But something concerning about the crypto community is that I see evidence there's just not much concern for the environment in general. Improvements in energy usage could be made, but progress seems to be overpowered by financial interests or convenience. You can see this in the slow move from power consuming proof-of-work blockchains to more efficient proof-of-stake blockchains.

I've also seen this pattern elsewhere, like how Ethereum NFT marketplaces could have saved a massive amount of energy and artists' money just by allowing works to be listed for sale without minting it on the blockchain ("lazy minting"). Implementation is relatively straightforward and simple, and there's no reason lazy minting couldn't have been offered since the beginning. I see people requesting this feature from NFT platforms on social media, but they don't typically get a response. As a result, many artists now unnecessarily have a significant amount of money tied up in crypto that they are not likely to get back. I find posts on forums by artists in this situation who spent all their money on minting costs but are now unable to sell anything.

Financial Deregulation

Video games and banks have been accomplishing the same kinds of digital transactions for decades without using blockchain technology. Game economies had enough real world value that World of Warcraft gold mining farm operations appeared in China the mid 2000s.

Compared to traditional databases, what's unique to blockchain technology is that it doesn't require a central authority. This mechanism is fascinating, but many of the claims about the advantages of blockchain databases over traditional databases are vague or unfounded. However, blockchain's one huge unique effect is that it creates a liquid asset class that evades regulation by the Securities and Exchange Commission and other regulating entities, because it's a new type of distributed, autonomous, international machine with no central authority or admin password.

The SEC and FDIC were created in response to the crash of 1929 to avoid market manipulation, speculation, fraud, and other issues that led to events like the Great Depression. They try but do not always succeed at preventing disasters like Enron, the 2008 financial crisis, and Bernie Madoff. Arguably one of the most significant accomplishments of the Occupy movement was their 325 page letter to the FDIC containing recommendations of stricter banking regulations which was cited dozens of times in the actual FDIC ruling for the Volcker Rule; an attempt to prevent banks from making speculative investments.

Cryptocurrencies generally have the opposite effect, creating a financial market that's much more difficult for the SEC and other agencies to regulate. Even if you're a libertarian and a fully deregulated "buyer beware" financial market fits your politics, cryptocurrency still has problems since it doesn't fit the politics of other countries like China, where crypto is banned. Nine countries have now fully outlawed crypto, which accounts for more than 25% of worldwide internet users combined. This means that web3 and NFTs are mostly off the table in those locations, or at least severely limited and unpredictable. Additionally, 42 other countries have enacted severely crippling regulations on cryptocurrencies.

Current regulations on NFTs in China prohibit storing NFTs on a public blockchain, exchanging NFTs for cryptocurrency, or selling NFTs for profit, which does not seem compatible with the concept of a professional global art ownership registry. It also seems unlikely that China will loosen up the NFT market considering that they've strictly banned cryptocurrencies, and any lightening up on NFT regulations would allow collections of NFTs to be used as makeshift cryptocurrencies since they are almost functionally identical from the perspective of speculators. Living without China and other countries in the crypto space may be acceptable in the context of hyper competitive business, but it's at odds with some of the idealistic notions being marketed around NFTs, web3, and DAOs. A professional universal art registry that can't reliably include artists or collectors in China, Egypt, Iran, and other countries is a problem.

This new deregulated market of cryptocurrencies makes possible frictionless worldwide payments (except China, etc.) and things like 1-minute loans at the expense of an increase in energy usage, and a market with increased fraud, pump and dump scams, wash trading, and businesses that evade gambling laws. But is crypto trading really gambling and some kind of Ponzi scheme or fraud? Can it be both? Cryptocurrency as a whole functions similarly to a Ponzi scheme where recruiting more people into the system makes it seem like everyone's making money. And there are very strong indications that if major players cashed out, it would cause a crash and cash-out rush where only a relatively small percentage of

investors would actually get compensated, leaving a lot of people holding an empty bag. Many people agree that this risk is one of the primary reasons that participation in systems like this is unethical.

The difference between crypto and regular Ponzi-like schemes is that this is a programmable Ponzi scheme letting people run businesses within the system under limited SEC oversight. A scheme like this will gradually stop making money as an investment when new people eventually stop buying into the system, and typically the market will crash when it stops being productive. But in this case there is motivation for the top players to keep maintaining the system and avoid pulling out since crypto allows people to operate other things within the system, like other Ponzi schemes and unregulated businesses. Many in the space are actually just regular businesses that want to operate within a libertarian fantasy, but others are businesses that are various hybrids of gambling and scams, and their presence makes it harder to differentiate a good business from a scam business. But even though cryptocurrency has this "utility" of operating with limited regulatory oversight, the market still always has the potential to crash and wipe out a lot of people's money if major players lose confidence. [One report](#) shows that 64% of people investing in crypto in 2021 used credit.

Keep in mind that traditional art collecting frowns upon "flipping" artworks (selling after a short time of ownership) because ideally you want artworks to go to collectors who will live with work and who are building serious collections that may someday end up in a museums or archives. However with NFTs, flipping is not only acceptable, but the frequency and prevalence of flipping in the NFT world is on a completely different level. And when you reduce friction, time-compress, and raise the stakes on art trading to where it will inevitably have the same dopamine responses as something like sports betting, then it's not really the same game anymore. The chairman of the SEC, Gary Gensler, agrees and has compared crypto schemes to unlicensed gambling: "We've got a lot of casinos here in the Wild West"

Crypto's deregulated market also makes it conducive to crime. Crime in crypto is sometimes dismissed as a non-issue, but I believe this is partly because the crypto industry has been providing crime information that is questionable, and I'm not the only person [who noticed this](#). Many reports and articles about crime are taking data from the same few companies in the crypto industry who stand to benefit from reports indicating low crime rates. One of the most commonly cited crime reports is from Chainalysis, but if you look at their actual report, the methods are primitive, and they state in the report that the given crime rate should be considered a "lower bounds", because it's only based on how much crime they can find with no real holistic analysis. A deeper academic crypto crime study from 2017 that was not connected to the crypto industry estimated total annual crime-related transactions at \$76b, whereas the same year Chainalysis reported only \$8b. A detailed analysis of cryptocurrency crime is beyond the scope of this essay, but crime statistics and information from the crypto industry should be taken with a grain of salt. Ultimately, probably few artists or institutions have any cause-effect relationship with crime in the crypto world, but I think it's important to understand the full landscape, and the high rate of crime and undeveloped security outside of the blockchain can make NFT, web3, and DAO projects a target of criminal activity.

The degree to which all these risks in crypto could lead to wider problems or economic disasters like 2008 depend on how big crypto gets and how well it can be regulated, but it's already huge and is naturally resistant to regulation. Crypto marketing often talks about how everything is public on the blockchain and that it's easier to avoid regulations or launder money with cash. But this is misleading because "coin shuffling" services can hide the tracks of crypto transactions, allowing the money to easily be shuffled to poorly regulated jurisdictions. The crypto system is also conducive to inventing new ways to evade the SEC and other regulators and to potentially keep them on a treadmill of regulations. A key legal battle in regulations might come down to some aspect of decentralized coin shuffling services,

which the crypto industry will [frame as a battle for privacy](#) and could go to the unpredictable Supreme Court. A critical loss could leave regulators toothless. Even if the crypto industry can be fully regulated, significant political bartering power may need to be expended to get it there, like deregulating the traditional financial markets in exchange for more regulation of crypto.

Art's Relationship to Crypto

The crypto industry is ridiculously complex, and it's not easy for an artist, curator, or institution to determine their true relationship within it and what effect that has.

I see that artists and people in the art world are genuinely concerned about the energy usage issues and the hyper-commercialization of the NFT market, and many were wary of a market going from nothing to astounding prices and popularity overnight. But then people understandably came away with differing opinions on the energy usage issues depending on which materials were read and how they weighed everything out. Energy became a divisive issue that may have obscured some of the deeper problems with crypto and NFTs, like its functional issues and political implications. A lot of the strongest and most vocal criticisms of crypto products are coming from the software developer community and economists, and I noticed that until recently this wider criticism was somewhat isolated from the art community.

I don't engage with NFTs, but I didn't write this to call out people who have. I just wanted to share perspectives I wasn't seeing in the art and NFT space about this system in which the art world is now deeply involved.

It's worth noting that before NFTs, many digital artists were originally drawn to digital art specifically because it was non-commercial, and a good number of those artists will probably never engage with NFTs even if blockchain authentication continues to be popular. Additionally, a large portion of digital art just doesn't fit well into the NFT market or format, and I've already noticed how the proliferation of NFTs is starting to narrow the vision of what people consider digital art to be. I hope curators and writers will continue to remind people that the artwork people currently associate with "NFTs" is only one of many interesting forms of digital and technological art.

Further Reading

[note: I'm still deciding which articles to include and in what order...]

Geraldine Juarez on NFT Ghosts (also see the linked essay in the interview):

<https://the-crypto-syllabus.com/geraldine-juarez-on-nfts-ghosts/>

The problems with Nifty Gateway by Joanie Lemercier:

<https://joanielemercier.com/null-and-void/>

Very few artists are making money off NFTs:

<https://thatkimparker.medium.com/most-artists-are-not-making-money-off-nfts-and-here-are-some-graphs-to-prove-it-c65718d4a1b8>

web3 problems by Moxie:

<https://moxie.org/2022/01/07/web3-first-impressions.html>

Slate article about Stablecoin risk, SEC chairman talks about crypto as gambling:

<https://slate.com/technology/2021/10/tether-crypto-danger-ben-mckenzie.html>

Robert Reich on crypto, congress, and lobbying efforts:

<https://robertreich.substack.com/p/crypto>

60% of people investing in crypto in 2021 borrowed money to do so:

<https://www.kisbridgingloans.co.uk/finance-news/cryptocurrency-consumer-research-and-data-autumn-2021/>

The Case Against Cryptocurrency:

<https://www.watershed.co.uk/studio/news/2021/12/03/case-against-crypto>

Why DAOs don't work as advertised:

<https://world.hey.com/marin/daos-and-the-nature-of-human-collaboration-be162918>

The Third Web:

<https://tante.cc/2021/12/17/the-third-web/>

Stolen money as a result of inexperienced developers in crypto:

<https://www.nbcnews.com/tech/security/bitcoin-crypto-exchange-hacks-little-anyone-can-do-rcna7870>

Tezos investigation:

<https://www.reuters.com/article/us-bitcoin-tezos-idUSKBN1FT2VI>

Long, sordid story of Tezos:

<https://www.reuters.com/investigates/special-report/bitcoin-funding-tezos/>

History of Ethereum's governance problems:

<https://tomerstrolight.medium.com/the-problem-with-ethereum-af9692f4af95>