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# Viable and attractive Bitcoin

**N**obody knows what will happen with Bitcoin. It will be only dependent on how the governments of different countries react to this virtual currency and how individuals and businesses accept it. While mainstream media picked up Bitcoin's stories in 2013, it will not be until 2014 that it will fulfill much of its potential as the digital form of cash. Three key developments over the past year helped Bitcoin achieve its goals, and it's now clear that Bitcoin will remain a viable form of payment over the long term.

The government which accepts Bitcoin, legalizes the currency and identifies it with rules and regulations, will have the most advantage over others. This will allow individual and businesses to build a payment system which will be "faster, more secure, and more efficient." As it will promote a transparent economy, users of the system will want to identify themselves and abide to the laws, by paying taxes and duties over Bitcoin transactions. The government's welcomeness, while discouraging those who believed it would help circumvent government's power to regulate commerce, will help improve Bitcoin's image among the larger population. Associating with Bitcoin will not mean you are dealing with black market goods and services.

The high volatility of Bitcoin's price to dollars was thought to be an impediment to its use as an actual currency as opposed to commodity. It was believed speculators would stockpile Bitcoins, and none would be spent. However, as merchants will start to accept Bitcoin after the government's positive response and a proliferation of processing services, those who believed their Bitcoins wouldn't appreciate any more in value spent them on goods for which they previously would have used dollars. And merchants, who believed in appreciating Bitcoin prices, gladly accepted. Of course, both those who spend and those who accept will be wrong about the price at different times, making such transactions still a bit riskier than using cash. However, a



Bitcoin's price will be fairly stable - around \$1,000 per Bitcoin in the first half of 2014 - and by end would be growing at a steady rate helping confidence in acceptance.

As industries and Internet related business start using Bitcoin and accept it as a payment protocol, it will bring more awareness in the market, the more number of users of Bitcoin will mean a stable price. Such consumer services made it dramatically easier for the average consumer to use Bitcoin and helped solidify its position as a viable currency.

The major price fluctuation from mid November 2013 till mid of December 2013 saw a deep fall of the price of Bitcoin from \$400 to \$1200 and back to \$550, which was only because of a group of company/individuals trying to manipulate the market. Initially, BTChina entering the market brought up the price and their decision of not accepting deposits reduced the price. This is just a correction over a single company penetrating the market. But, the overall impact, is more than 100,000 users got interested in Bitcoin, are glued to it too. Hence the price did not go below \$500. The year 2014 will also see a similar trend in mid May, as Bitcoin Foundation's next annual conference

will be conducted in Holland. We expect more discussions from government and legal authorities.

These three developments helped Bitcoin achieve success as a digital currency in 2014. The days of hoarding speculators have passed, as well as questions of legality, ease of use, and fly-by-night exchanges. The competitive payment landscape lowered margins for payment processors but opened up new avenues of commerce.

Assuming Bitcoin becomes (a) a major player in both ecommerce and money transfer and (b) a significant store of value with a reputation close to silver, the fair value analysis implies a maximum market capitalization of Bitcoin of \$15bn (1BTC = 1300 USD). This suggests that the 100 fold increase in Bitcoin prices this year is at risk of running ahead of its fundamentals. Tamper-proof, limited supply and divisibility Bitcoin can become a major means of payment for ecommerce and may emerge as a serious competitor to traditional money transfer providers. As a medium of exchange, Bitcoin has clear potential for growth, in our view.

It has been reported that Bitcoin may help users avoid high taxes, capital controls, and confiscation. The fact that

all Bitcoin transactions are publically available and that every Bitcoin has a unique transaction history that cannot be altered may ultimately limit its use in the black market/underworld. Bitcoin will only be used for legal transactions in coming years.

Bitcoin's role as a store of value can compromise its viability as a medium of exchange. Its high volatility, a result of speculative activities, is hindering its general acceptance as a means of payments for on-line commerce.

As a medium of exchange, Bitcoin is attractive as it offers low transaction costs. It does so by eliminating the need for a central clearing house or financial institution to act as a third party to financial transactions. Using a decentralized, peer-to-peer network, transactions are verified independently by network users (i.e., miners) who are rewarded for their work with newly minted Bitcoins. In addition, it provides an alternative payment method to users who may not have access to credit or debit cards, or, other forms of electronic payments.

Bitcoin offers an attractive alternative to cash in terms of security, transparency of transactions, and counterfeiting. Bitcoins reside in an encrypted format on their owner's computer, making it difficult, though not impossible, for hackers to access and steal electronically. Physical Bitcoin theft is also possible, but it seems no easier to carry out on a larger scale than for cash.

In addition, given their digital format, Bitcoins are much easier to carry than cash, which could be a particular benefit in economies where large scale transactions are conducted in cash. Bitcoin also offers the benefit of being easier to track than cash given that each coin contains an electronic record of each transaction that coin has gone through since it was created. Not only is each transaction recorded on each Bitcoin, but all transactions are recorded in an online public ledger, offering a level of transparency that is not available with cash. Such transparency offers regulators means to track potentially illicit activity.

Lastly, the digital format with automatic verification

also makes it impossible to counterfeit. There is a finite supply of Bitcoins. The design of Bitcoin seeks to mimic the supply of gold in that the system will create a finite supply of the currency, which its proponents see as a way to protect its value from profligate governments or central banks. The system is designed such that the supply of Bitcoins will increase over time until it reaches a total supply of 21 million. In order to achieve this target, the incremental supply of new Bitcoins will decrease geometrically by 50% every four years. Bitcoin's relative anonymity is advantageous to citizens of crisis countries. It has been reported that some believe Bitcoin can be used by those seeking to avoid high taxes, capital controls, and confiscation.

"Winner Takes All" market ensures that increasing acceptance and popularity of Bitcoin increases likelihood of success. As Bitcoin becomes more popular, competitors will face higher barriers to entry, making it less likely they will be successful in supplanting Bitcoin's market share. Several other digital currencies with similar features to Bitcoin have been introduced with limited success. However, we believe the structure of the digital currency market is one of "Winner Takes All" whereby as Bitcoin becomes more popular and is easy to use, consumers will have much less incentive to experiment with an alternative currency with similar features. Bitcoin offers large benefits (from an asset allocation perspective) given its negative correlation with risk sensitive assets, much like gold.

Bitcoin's role as a store of value is seriously compromised by its elevated price volatility. The dollar price of Bitcoin has moved 10% on a daily basis since its inception including days when the price moved 190% from that day's highs to lows. It can be argued that these swings reflect shifts in estimates about the fundamental value of Bitcoin as more people become aware of it, or, use it.

*Views: your feedback is important to us, please email us at nilamdoc@gmail.com.*