The Status of Bitcoin

Name

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# Introduction

Bitcoin is a digital type of currency that is software based. It is a cryptocurrency, meaning that it uses cryptography for purposes of security. The use of cryptography makes it difficult to counterfeit this type of currency. Cryptocurrencies differ from regular types of currency in that they are not issued by any central authority. This nature makes them free from government interference and from manipulation. Bitcoin was launched in 2009, with several other cryptocurrencies such as Litecoin and PPCoin following suit. It facilitates peer to peer transfer of funds, without having to rely on financial institutions as an intermediary. In this way, users are able to avoid the transaction fees and other fees associated with traditional forms of currency, thus cutting costs (Thomas, 2016). The merits and demerits of Bitcoin as an investment are discussed.

# Bitcoin as Money

The nature of bitcoins raises the question of whether it qualifies as a type of money. Evidently, Bitcoin currency is fundamentally different from what is traditionally considered as currency. One can analyze whether bitcoin currency is a form of money by considering the three functions of money and whether it fulfills these functions. The three functions that money serves are as a medium of exchange, a unit of account and a store of value.

The first function that money serves is as a medium of exchange. It allows users to acquire what they want by exchanging with something of commensurate value. It is through this function that individuals are able to buy and sell goods. Money creates a standard of value, whereby there does not have to be a coincidence of wants. For a money system to be efficient, it should be acceptable by a sufficiently large number of individuals or institutions. Under this function, Bitcoin qualifies as a form of money since it has gained wide acceptability by a large number and wide range of users. Bitcoin is being used for many different transactions. An infographic by CNN Money highlights that some of the products that can be accessed using bitcoin include web hosting services and even trivial services such as manicures (Yellin, Aratari, & Pagliery, 2016). The ability to access such transactions using bitcoin highlights its ability to fulfil the medium of exchange function.

A second function of money is as a unit of account. Money facilitates a measurement of the relative worth of goods and services. This is part of the reason why it is able to serve as a ubiquitous medium of exchange. There are several characteristics that make money suitable as a unit of account. First is that it is divisible, meaning that it can be broken down into smaller components whose value equals the original value. For instance, a single Australian dollar may be broken down into a 50 cent coin, two 20 cent coins and two 5 cent coins. The value of these coins or any other combination amounting to 1 dollar would still have the same value as an Australian dollar. A money system should also be fungible. This quality implies that one unit of the money should be the same as any other such unit without a change in value. For instance, half a bar of gold would be equal in value to another half bar. In contrast, items such as diamonds differ in value based on qualities such as color. A final characteristic is that a unit of account is also countable, allowing it to be subjected to a range of mathematical operations such as addition and subtraction. (Lo & Wang, 2014) indicates that bitcoins high volatility makes it an unsuitable unit of account. Additionally, according to Hern (2014), bitcoins differ based on the cost of purchasing the bitcoin. However, Bitcoin is in fact used as a unit of value, and this is what facilitates its use as an exchange medium. In this sense, it satisfies this condition.

The final function of money is as a store of value. Money is able to achieve this function due to its high liquidity. Money retains value over extensive periods of time and as such, can be used to store wealth. Bitcoin indeed serves this function. The value of Bitcoin is, however, highly subjective and relies entirely on the expectations of users that the bitcoin will rise in value (Lo & Wang, 2014). The

# Bitcoin Money Versus Traditional Money

Other money systems include commodity systems and the fiat system. Bitcoin differs from traditional money in a number of senses. The major difference is that Bitcoin is a cryptocurrency. It is a decentralized type of currency that has no intermediary. Commodity based money is based on an item(commodity), held in high value by the different individuals amongst whom it is transacted. Gold is the oldest and most popular commodity based system of money. Any type of commodity may be used so long as there is a common consensus about the value of that commodity. For example, (Gobry, 2013) highlights how in jails, cigarettes are commonly used as money. Fiat money, in contrast, derives it authority from a government decree, also called a fiat. Under this system, a government declares that a certain declares a certain money to be money of a particular value. In principal, there are other differences between fiat money and Bitcoin. Fiat money is controlled by the government in terms of the amount in circulation. The amount in circulation determines the value. As such, fiat money is liable to hyperinflation, if the government oversupplies currency. Bitcoin is able to overcome this limitation since it is not controlled by any central authority, and instead more user-driven. This makes the Bitcoin system less prone to exploitation.

# Potential of Bitcoin

Bitcoin has grown in the popularity of its use since its invention and introduction. (Lo & Wang, 2014) reports that it is highly volatile even compared to the typical inflation rate on most goods and services. This indicates its sporadic popularity, which has however stabilized in the recent years. As noted, Bitcoin can be used to purchase webhosting or even pizza. Moreover, (Coindesk.org, 2015) points out several entities including Microsoft have begun accepting bitcoin as a form of payment. It can also be used for smaller and casual transactions (Nakamoto, 2008). There are other advantages associated with bitcoin, such as its decentralization and the absence of direct fees on transactions. This makes it a very attractive system. In addition, Bitcoin characterizes a pseudonymous system, where buyers do not have to reveal their identity in order to secure a transaction. Finally, Bitcoin facilitates peer to peer transfer, allowing users to bypass intermediaries. For these reasons, bitcoin has a very positive potential to compete with fiat money. Some of the factors which however limit its potential include the lack of recognition by the government. Nonetheless, attempts to disown and illegitimize the system have often not been successful, since its popularity and usage has continued.

# Australian Government View of Bitcoin

The Australian government, similar to many other governments, attempted to disown and illegitimize the Bitcoin. This is by refusing to treat it as money and declaring that it will instead be treated as a commodity. As such, it is taxed as capital, and thus subject to capital gains tax. More recently, however, the government has changed its view on Bitcoin, declaring an interest in treating it as other standard monies. The government, however, softened its stance a year later. in 2015, the Senate Economic reference committee recommended that alongside other digital currencies, Bitcoin be recognized as money (Coinfox, 2016). Moreover, action aimed at reducing taxation and eradicating double taxation on bitcoin is underway. This indicates that essentially, the Australian parliament has a favorable perception towards Bitcoin.

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