



# **Money & Trust in Digital Society**

Bitcoin and Stablecoins in B2B  
Mixed Reality

Draft product design Flossverse & PathwayXR

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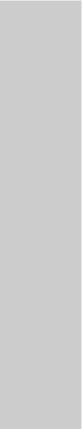
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## 0.1 **Conflict of interest statements**

The authors may own small numbers of the various tokens referenced in the text for experimentation and/or investment purposes. At this time that is only sufficient Ethereum to operate a Web3 wallet, and Bitcoin locked on the Lightning network. No NFTs are owned at this time. There are no financial stakes in the development of any of these ecosystems.





# 1. Introduction

## 1.1 Overview

As human beings, we have always relied on certain social constructs to guide our interactions and transactions with one another. Money and trust are two such constructs that have played a vital role in shaping our societies, and the way we live our lives. However, the digital age has brought with it new challenges that are testing the foundations of these social norms.

In a world where we are increasingly connected through the internet and able to communicate with people from all corners of the globe, the concept of money and trust is changing. Gone are the days of the village structure in which we evolved, where personal relationships and face-to-face interactions were ubiquitous. Now, we are faced with the prospect of working and interacting one another, and also with artificial intelligence actors that seem subjectively real, all while navigating the complexities of a global mixed reality.

This transition to a more efficient and interconnected world has the potential to bring about great benefits, but it also presents us with an enormous challenge. The chaotic and intangible mix of value, trust, socialisation, generative art, and AI chat actors, is not yet well understood, and it will take time for us to adapt to this new way of living and interacting with one another.

We initially wanted to explore exciting new developments in the transmission of value, and trust, in ‘digital society’. The problem is that each of these topics alone are enormously complex, and the intersections seem to be more so. We have been researching the current state-of-the-art, and the emerging consensus narrative, to try to figure out how the collision of these technologies might serve our virtual production workflows (Figure 1.1). As we worked on this research the Cambrian explosion of generative AI added an incredibly important new strand to our investigation.

Over the course of a couple of years the focus of the work has developed, and refined. Our tool-kit, as it stands, supports inclusive human creativity and economic exchange, especially for emerging markets and the global south. There is a huge proportion of human creativity currently excluded from media production pipelines due to gatekeepers of knowledge, access to identity proofs, and financial infrastructure that is taken for granted in the richer nations. This inclusion will be accomplished for the most part through integration of open source machine learning and AI tools, but this field quite new, and that part of the work is under developed.

**If at this stage you want to skip straight to the TL;DR for the whole book then click this bold text.**

## 1.2 Introduction

This book is a high level view of technologies and their potential within the developing digital society narrative, focusing around the transmission of value within and across immersive global networks, with a further focus on the Bitcoin monetary network.

Cybersecurity is top of the list of concerns in the EU digital society strategy, just ahead of digital inclusion, so we started out with security best practices in mind, and we tried to end the investigation with inclusion. We aimed to support small and especially developing companies in our sector, giving them a foot in the door on a global stage, without their costs spiralling?

Fortunately, we discovered a wealth of carefully crafted open source tools which can support this. Open source software is software that is available with source code that can be modified and distributed by anyone. The model extended into other creative works through things like the Creative Commons licenses, which is itself an ‘open standard’. We will return to these themes throughout the book, and both this text and the supporting code are open source. This means that anyone can



Figure 1.1: Pathway XR virtual production

access, use, and modify the source code for their own purposes. Open source software is often developed and maintained by a community of volunteers, and it can be freely distributed and modified. This approach to software development allows for more collaboration and innovation, as well as greater transparency and security. Many popular software programs, such as the Linux operating system and the Apache web server, are open source.

We have tried to assemble the tools we found, cogently, to deliver an open source kit for experimentation, to curious technically minded SMEs outside of Pathway, and we have applied our own security knowledge on top of an already top class set of tools. It's certainly not production ready, but it's good enough to commit small amounts of money into, and collaboration with Pathway is welcomed.

Whilst researching, it seemed that every door we opened was full of interesting and useful treats. What was supposed to be a short technical paper quickly became a 200-page book, and a deployable virtual machine stack, with a dozen different open source components in it.

This book supports the software stack, which supports anyone who

thinks this material might be useful. Below is a précis of the chapters of the book, which will hopefully give an insight into what “this stuff” is. The reader can decide to download the book and the system “How To” guide. All of it is open source, all of it can be contributed to on GitHub, all of it will be developed forward, and none of it is really finished yet.

Chapter 1 starts with an introduction to the book which is about value transmission, with distributed trust, in global digital society and mixed reality systems.

Next is a summary of Web3, as it stands right now. Web3 is a complex term that is cropping up far more in the technical press, so we wanted explain what it might mean. Honestly, it’s still pretty confusing. There are a bunch of legacy explanations which are Web3.0 (note the ‘0’ there), but these are withering on the vine. Then there’s the new VC funded, super hyped, and potentially useless Web3 incarnations, which again cover a slew of intersecting technologies. Note they dropped the zero to reboot the brand! This doesn’t mean there’s nothing to see here. The astonishing amount of money and developer talent, and the clear market hunger for things like NFTs (non-fungible tokens) suggest that there’s a future for Web3, it’s just really unclear if this is inherently valuable or just hype.

In the next chapter we took a look at blockchain, which is very intersectional with Web3. Even on its own this is a complex emergent set of disciplines.

The blockchain chapter was especially interesting to research. It turns out there’s a *lot* of ways to get this technology wrong. Even very appealing options on paper, turn out to have very shaky foundations. There are valuable things here, but given the complexity and scope, we decided to focus on the most promising of the technology stacks; the Bitcoin network.

Even Bitcoin isn’t just Bitcoin any more. It’s a swarm of open source tools which can (in theory) accomplish a great many things. These newer, ancillary elements to Bitcoin, are emergent right now. Some of them won’t be around until next year, and it’s questionable whether they will even work out. With that said we aren’t convinced by the value proposition of Ethereum, and there’s enough Bitcoin tooling for us to cherry pick useful components. We map those forward into our metaverse product.

The next chapter is about Money. In expanding our research on Bitcoin, we found that it’s impossible to think about the tech without opening up a whole line of questions about money itself. This is fine

because we set out to look at global value transfer for business. It's not a trivial subject though, and this section tries to overview why value and Bitcoin are so enmeshed, then what other options there might be in the end (because Bitcoin has kicked off a whole slew of global adoption outside of itself).

The distributed identity management, and trust chapter follows. Identity management is important for digital society and potentially crucial to metaverse applications which have a value transaction layer. It's not an easy section to write about, because there's a lot of research, it's not our field, and finding the value to SMEs has actually been very difficult. It's by no means clear that blockchain is the right tool for this component, and newer cryptographic products are emerging.

In chapter 7 we take another look at NFTs. It's impossible to ignore this stuff now. It's fundamentally a bit broken, but there are probably use cases, and the money and development attention it's getting are incredible. We try to navigate our hypothetical virtual production partners through this as best we can.

We're actually pretty excited about future versions of 'digital assets', based around Bitcoin, because that allows us to keep just one software stack, minimising the threat surface. We've mapped that forward into the open source tools that we recommend.

Chapter 8 is a big one for us as it's our research area prior to opening up the Bitcoin box(es). Metaverse, or at least one of the current definitions of metaverse, is just social interaction in mixed reality (VR/AR/XR). We've been studying that for decades, so this section is more academic and tried to boil down what we think is most important. The choices we made here guided us toward the selection of free and open source metaverse software.

We also take a look at the other definitions of 'metaverse' which are doing the rounds on the web, try to unpick which is which, and what they are for, and attempt to weave back together the best of both. This ends up looking a bit like the Venn in Figure 1.2, where we have transmission of provable identity, non-fungible tokens bearing value or data, distributed files, actual money (including micropayments) and a social layer based on our best knowledge about mixed reality. In the end we abandon the word metaverse and settle on 'digital society' as our preferred term.

It's exceptionally fortunate timing for this book that the UK government has signalled enthusiasm for so called 'stablecoins' at the same time that the Bitcoin network is being upgraded to transmit these GBP equivalent tokens around. This gives us a very good idea what it is we

can build into our application stack.

Past this stage in the book we get into the murky and half developed tail end, where we're interfacing with our design choices, and the stack which can be deployed into the cloud.



Figure 1.2: Web 3, Metaverse, and Bitcoin are intersectional technologies.

As adoption of these technologies increases it will be necessary for people, and AI actors, to pass economic value between themselves. These ‘goods and services’ interactions, within the digital and virtual social spaces should be underpinned by a trust system, which scales globally and presents low friction. Current secure international payment rails are poorly suited to such interactions; indeed it is likely with legacy systems, that parties would be forced to leave the metaverse application, and instead navigate their banking applications to exchange value with overseas entities in a secure fashion. This might conceivably take several days.

Fortunately, the whole landscape of money and value transfer is changing. Huge global financial players are entering the space. HSBC have just bought metaverse ‘land’ in The Sandbox, JP Morgan have opened a ‘lounge’ in another. The world’s largest hedge fund Bridge-

water is stepping into acquisition of digital assets, and the world's largest pension fund manager Blackrock partnered with crypto behemoth Coinbase and is adding these asset to their management engine (which manages tens of trillions of dollars). America's oldest bank BNY Mellon, and even the Nasdaq stock exchange are offering service to institutional clients, and Fidelity asset management are about to add Bitcoin to their pension plans. Fidelity are also offering a dedicated metaverse tradable fund, and considering more direct product offerings through their retail investment engine. Citigroup have a minisite dedicated to "Metaverse and Money". The front page of Goldman Sachs recently says it all (Figure 1.3).

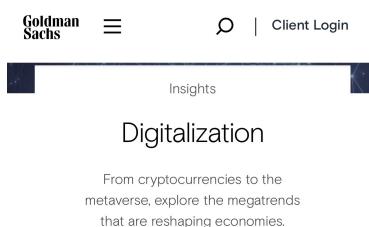


Figure 1.3: The landing page of global financial giant Goldman Sachs shows the hype.

In Gartners 2022 hype cycle report one of their three “trend themes” says: *“The future of digital experience is immersive. A collection of emerging technologies supports such experiences through dynamic virtual representations, environments and ecosystems of customers and people, as well as new modes of user engagement. With these technologies, individuals can control their own identities and data and experience virtual ecosystems that can be integrated with digital currencies. These technologies help reach customers in new ways to strengthen or open new revenue streams. The technologies to watch that deliver evolving and expanding immersive experiences are metaverse, non-fungible tokens (NFTs), super apps and Web3, decentralized identity, digital humans, digital twin of the customer and internal talent marketplaces.”*

Of their recent investments KPMG global said: *“We've invested in a strong cryptoassets practice and we will continue to enhance and build on our capabilities across Decentralized Finance (DeFi), Non-Fungible Tokens (NFTs) and the Metaverse, to name a few”*. This is not to say that all fund managers are so positive. PGIM who manage

over a trillion pounds globally have come out very strongly against the technology, with a slew of reports to warn off investors (Figure 1.4).



Figure 1.4: PGIM cite ‘digiconomist’, a prominent critic.

It's possible that for such huge organisations it makes better business sense to take a punt on hype bubbles like this, than to do a proper due diligence with a team of internal staff who understand their business. These endorsements should be taken with a large pinch of salt. As Alex Johnson says: *“At some point in the future, it’s possible that the digital worlds being built today will have aggregated sufficient user attention and engagement that financial services companies will need to invest in the metaverse as an acquisition and customer service channel. But we’re not there yet. Until the metaverse is a little less empty, resist the temptation to colonize it with branches and billboards.”*

Meanwhile, Meta (ex Facebook) are launching their own META Web3 and metaverse token (after abandoning Libre, their global cryptocurrency), and Google have formed a strategic partnership with Coinbase, and recently blogged: *“Web3 also opens up new opportunities for creators. We believe new technologies like blockchain and NFTs can allow creators to build deeper relationships with their fans. Together, they’ll be able to collaborate on new projects and make money in ways not previously possible. For example, giving a verifiable way for fans to own unique videos, photos, art, and even experiences from their favourite creators could be a compelling prospect for creators and their audiences. There’s a lot to consider in making sure we approach these new technologies responsibly, but we think there’s incredible potential as well. Finally, we couldn’t have a piece about innovation without touching on the metaverse! We’re thinking big about how to make viewing more immersive.”*

It's already the case that the recent bubble of hype is dwindling, but the enormous investment into teams and startups will potentially bear fruit in the next couple of years, and this perhaps has implications for small and medium-sized enterprises. PathwayXR is both an SME and

well positioned in this highly convergent moment.

In the UK the government has stated it's ambition to be a global cryptoasset technology hub, and announced plans for the Royal Mint to issue a (novelty) NFT. Fuller, Economic Secretary to the Treasury said in a speech: "*We want to become the country of choice for those looking to create, innovate and build in the crypto space [...] By making this country a hospitable place for crypto technologies, we can attract investment, generate new jobs, benefit from tax revenues, create a wave of ground breaking new products and services, and bridge the current position of UK financial services into a new era.*"

Like the assertion by major global businesses it is too early to tell how 'sticky' these claims are, but the UK legal system is clear in it's view that all crypto assets are 'property'.

A Law Commission consultation on "digital assets" has proposed a new **third category** of property:

- *it is composed of data represented in an electronic medium, including in the form of computer code, electronic, digital or analogue signals;*
- *it exists independently of persons and exists independently of the legal system;*
- *it is rivalrous such that use by one prejudices the ability of others;*

Consensus seems to be that this is a thorough paper, and demonstrates strong knowledge of digital assets by the authors.

Gartner's hype cycle 2022 features Web3, distributed identity, NFTs, and Metaverse and can be seen in Figure 1.5.

With all this attention it seems timely to explore the potential of recent technologies, which can address metaverse interactions in *business to business* (B2B), *business to customer* (B2C), and the newer C2C (social commerce; *creator to consumer, customer to customer, consumer to consumer*[1]).

This book seeks to overview and explain the available open source technologies. It supports an open source [github repository](#) which enables SMEs to access these emergent platforms and ecosystems. It aims to build toward a minimum viable product for trust minimised transfer of value within a social immersive space, but also across all internet connected devices.

Referencing is in two styles; academic works and books are numeric, while opinion pieces, gray statistics, and pertinent news articles are hyperlinked from the text. This hybrid style yields about twice the citation density of a normal PhD thesis, which is a lot. For this reason the normal blue hyperlink colour was eschewed in favour of a more

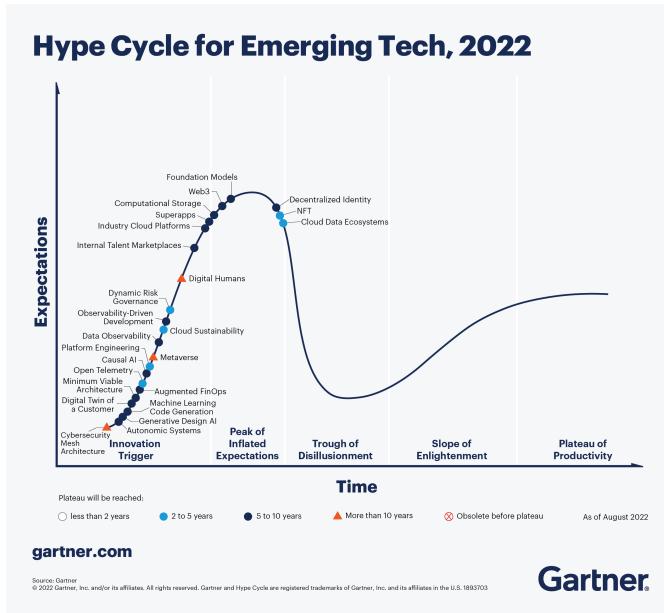


Figure 1.5: The Gartners Hype Cycle for 2022.

aesthetic “gray”.

### 1.2.1 Notes on progress

This version of the book is being overhauled to improve the focus, and expand the virtual production use cases. It may be inconsistent and look scrappy until this message is removed.



## 2. Decentralisation & Web3

When this chapter was first started in early 2022 ‘Web3’ was at the peak of it’s hype. Web3 is still a rapidly evolving set of technologies and specifications, which are drifting further from their origin. Decentralised web is perhaps a more useful name.

### 2.1 Semantic web

The “semantic web” definition of Web3.0 has been somewhat overhauled by other innovations in decentralised internet technologies, now evolving toward the slightly different Web3 moniker. Tim Berners Lee (of WWW fame) first mentioned the semantic web in 1999 [2].

“I have a dream for the Web [in which computers] become capable of analyzing all the data on the Web – the content, links, and transactions between people and computers. A "Semantic Web", which makes this possible, has yet to emerge, but when it does, the day-to-day mechanisms of trade, bureaucracy and our daily lives will be handled by machines talking to machines. The "intelligent agents" people have touted for ages will finally materialize.”

Attention developed around three core themes, ubiquitous availability and searchability of data, intelligent search assistants, and highly available end points such as phones, and ‘internet of things’ devices. This is certainly manifesting in home devices, but few people think

of this as a Web3 revolution. Since ratification of the standards by the World Wide Web (W3C) consortium it seems that their imperative toward decentralisation has become lost. Instead, it can be seen that Facebook, Amazon, Google, and Apple have a harmful oligopoly on users data [3]. This is at odds with Berners-Lee's vision, and he has recently spoken out about this discrepancy, and attempted to refocus the media onto Web3.0.

It is worth taking a look at his software implementation called Solid, which is far more mindful of the sovereignty of user data.

"Solid is an exciting new project led by Prof. Tim Berners-Lee, inventor of the World Wide Web, taking place at MIT. The project aims to radically change the way Web applications work today, resulting in true data ownership as well as improved privacy. Solid (derived from "social linked data") is a proposed set of conventions and tools for building decentralized social applications based on Linked Data principles. Solid is modular and extensible and it relies as much as possible on existing W3C standards and protocols."

Excitement around this kind of differentiated trust model, hinted at in ubiquitous availability of data (and implemented explicitly in Solid), has led to exploration of different paths by cryptographers, and this will be described later. For instance, one of the main developers of Solid, Melvin Carvelho, is now a lead developer at Nostr, another very interesting option which will be described later. This technology space is prolific, but still comparatively young and small.

## **2.2 Spatial web**

"The Spatial Web", a blurring of the boundaries between digital and geospatial physical objects, seems to have developed from the strands in the original W3C scope around devices in the real world. It has been concentrating around AR and VR but is being marketed and amplified with the same references to availability of data (See Figure 2.1 from a Deloitte accounting report). This too is finding little traction in practice, though obviously the component technologies continue to enjoy rapid development. Nonetheless, this interpretation of Web3 becomes valuable when examining Metaverse later.

## **2.3 Web3**

More recently Web3 is being touted as a way to connect content creators directly to content consumers, without centralised companies acting as

### Three tiers of IT infrastructure and building the Spatial Web

As the technologies and capabilities that compose and connect IT architecture converge, the Spatial Web will mature. The figure below shows how key enabling technologies drive their respective computing eras.



\*Note: Date ranges are approximate and meant for directional purposes only.

Source: Deloitte analysis adapted from Gabriel René and Dan Mapes, *The Spatial Web: How Web 3.0 Will Connect Humans, Machines, and AI to Transform the World* (Amazon, 2019).

[Deloitte Insights | deloitte.com/insights](https://www.deloitte.com/insights)

Figure 2.1: Deloitte Spatial Web Overview Reused with permission.

gatekeepers of the data. It implies that all users have a cryptographic key management system, to which they attach metadata, that they make requirements of peers with whom they communicate, and that they maintain trust ‘scores’ with peers.

It seems likely that this new model is less driven by a market need, and more by the high availability of tools which allow this to happen (the ecosystems described later). Add to this a social response to the collapse in trust of companies such as Facebook and other social media platforms[4] (Figure 2.2). There is perhaps a wish by consumers to pass more of the economic incentive to content creators, without the ‘rent seeking’ layer afforded by businesses, and a healthy dose of mania driven market speculation. Edelman’s latest trust report is shocking, finding that trust in all institutions has slumped recently to all time lows, and their global survey found that: *“Nearly 6 in 10 say their default tendency is to distrust something until they see evidence it is trustworthy. Another 64% say it’s now to a point where people are incapable of having constructive and civil debates about issues they disagree on. When distrust is the default – we lack the ability to debate or collaborate.”*

### **2.3.1 Emerging consensus**

The current hype cycle is ignoring the legacy definitions described above and instead focusing almost exclusively on Ethereum based peer-to-peer projects. It can be seen that the description is somewhat in the eye of the beholder.

It’s possible to frame this Ethereum Web3 as a hugely complex and inefficient digital rights management system (DRM). DRM is something that users of the internet are increasingly familiar and comfortable with. It’s somewhat debatable whether decentralising this is worthwhile. The thesis of the developers of the technology seems to be that without it, control of ‘value’ will accrete over time, to one or more hegemonic controlling entities. It’s a strong argument, but there is a substantial counter argument emerging that users just don’t want this stuff. The nervousness of legislators in the USA to the attempt by Facebook/Meta to enter this peer-to-peer value transmission space is telling in terms of the perception of who is driving Web3.

Throughout 2022 there has been much furore on the internet over what Web3 might be, and who it ‘serves’. Enthusiasts feel that products such as Sign-In with Ethereum (EIP-4361) will give users choice over their data sovereignty, and a meme to this effect is seen in Figure 2.3. In practice though users are expecting to use badly written, buggy,

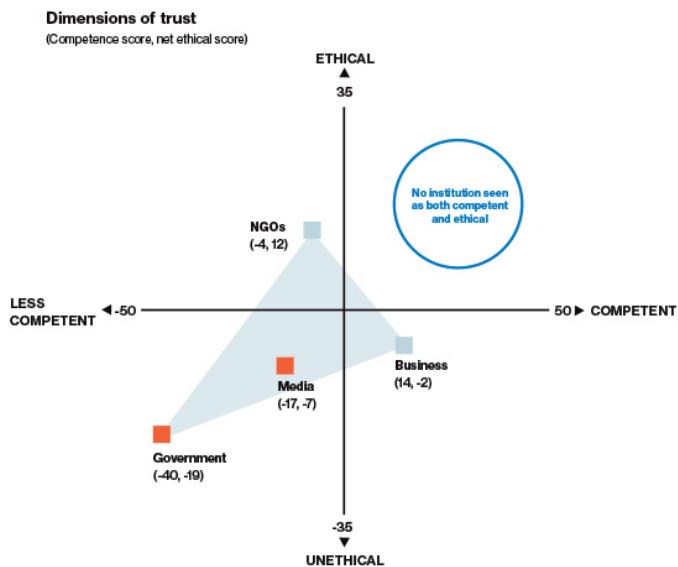


Figure 2.2: Edelman 2020 trust barometer [rights requested]



Figure 2.3: A meme showing differing approached to logging in on a website.

economically vulnerable ‘crypto’ wallets to log into websites. The quality of this wallet software is improving of late with the so called “wallet wars” seeing commerce grade offerings from Coinbase and shares platform ‘Robinhood’. These two companies alone have over 100 million users. It’s likely that these wallets will evolve to offer the full spectrum of Web3 functionality. With that said it doesn’t seem to make much sense yet on the face of it. There are in fact examples of the technology completely failing at censorship resistance. Popular ‘Web3’ browser extension Metamask and NFT platform Opensea have both recently banned countries in response to global sanction pressure. This failure to meaningfully decentralise will be explored further in the distributed identity section.

This new hyped push for Web3 is being driven by enormous venture capital investment. A16Z are a major player in this new landscape and have released their ten principles for emergent Web3. Note here that A16Z are (like so many others) probably a house of cards.

- Establish a clear vision to foster decentralized digital infrastructure
- Embrace multi-stakeholder approaches to governance and regulation
- Create targeted, risk-calibrated oversight regimes for different web3 activities
- Foster innovation with composability, open source code, and the power of open communities

- Broaden access to the economic benefits of the innovation economy
- Unlock the potential of DAOs
- Deploy web3 to further sustainability goals
- Embrace the role of well-regulated stablecoins in financial inclusion and innovation
- Collaborate with other nations to harmonize standards and regulatory frameworks
- Provide clear, fair tax rules for the reporting of digital assets, and leverage technical solutions for tax compliance

This list seems targeted toward the coming regulatory landscape, and could be considered at odds with the original tenants of an organically emergent, decentralised internet. Indeed principles such as ‘furthering sustainability goals’ seem downright incongruous. The community they claim to wish to support here are openly critical of these major institutional players and their motives, with even more pointed criticisms coming from outside of the Web3. This book and lab steer well clear of these companies and their applications.

Dante Disparte, chief strategy officer of ‘Circle’ venture capital, said in testimony to a US senate hearing; that Web 1 was ‘read’, Web 2 was ‘read write’, and that Web 3 will ‘read write own’. The important takeaway here is not so much this oft quoted elevator pitch for Web3, but the fact that legislative bodies now consider this technology a force which they need to be aware of and potentially contend with.

Jeremy Allaire, again of Circle’, talks about the recent legislative order in the USA as follows: *“this is a watershed moment for crypto, digital assets, and Web 3, akin to the 1996/1997 whole of government wakeup to the commercial internet. The U.S. seems to be taking on the reality that digital assets represent one of the most significant technologies and infrastructures for the 21st century; it’s rewarding to see this from the WH after so many of us have been making the case for 9+ years.”*

We will see in the following chapters that participation in this new Web3 is contingent on owning cryptocurrencies. It’s estimated that about 6% of people in the UK own some cryptocurrency, with skews to both younger demographics, and smaller holdings. The legislative landscape in the UK is comparatively strict with questionable “know your customer / anti money laundering” (KYC/AML) data collection mandated in law. Users of UK exchanges must provide a great deal of personal financial information, and undertake to prove that the wallets they are withdrawing to are their own. From the perspective of the

UK SME it seems this seriously limits the potential audience for new products. Europe meanwhile has recently voted through even more restrictive regulation, applying the “transfer of funds regulation” to all transactions coming out of exchanges, enforcing a database of all addresses between companies, and reporting transactions above 1000 Euros to authorities. They have narrowly avoided enforcing KYC on all transfers to private wallets. The “Markets in Crypto Assets (MiCA) legislation is an onerous overhead that will likely make it impossible for smaller businesses in the sector to operate within the EU. This is still short of the ban that they have discussed in private. It seems that this EU position has prompted the UK government to seize the potential competitive advantage offered, and there will be more on this later. Japan meanwhile has gone so far as to make an announcement about supporting the technologies at a national level.

It’s a complex evolving narrative, and clearly contradictions are common. Right now there seems little appeal for stepping into Web3. Into the confusion, this book advances a narrow take, and toolset, which might extract some value from the technologies, while maintaining a low barrier to entry.

## 2.4 The common thread

One feature which persists throughout all of these interpretations of Web3 is the need for decentralised trust. According to Nathaniel Whittemore, a journalist for Coindesk, “The Web3 moniker positions this industry in opposition to big tech”. Alternatively the many detractors of the technology think it simply provides avenues for incumbents to experiment with new models of control and monetisation, increasing systemic risk at no cost to themselves.

Overall then, perhaps the space is hype, and is certainly rife with scams. The degree to which it even accomplishes decentralised trust is highly debatable, and meanwhile the limited numbers of Web3 and supporting crypto companies display lamentable cyber security practice themselves, creating honeypots of personal data from users of the ecosystem.

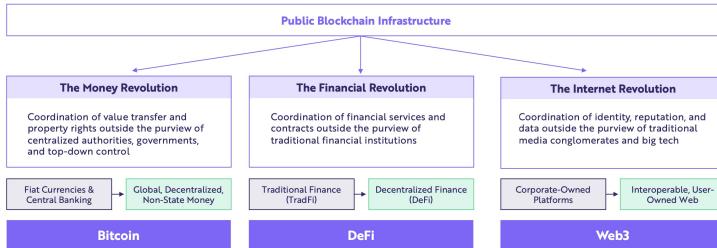
With that said the component parts necessary to deliver on the promise **do** exist. If there is to be no central controlling party(s) as in the Web 2 model then nothing can happen without a cryptographically secure underpinning, allowing digital data to be passed around without a prior arrangement.

The following chapter will describe how much has been done by



### Public Blockchains Are Stirring Several Revolutions

In our view, the Bitcoin protocol created the most profound application of public blockchain infrastructure. In addition to the Money Revolution, public blockchains also have catalyzed Financial and Internet Revolutions.



Forecasts are inherently limited and cannot be relied upon. | For informational purposes only and should not be considered investment advice, or a recommendation to buy, sell or hold any particular security/cryptocurrency. Source: ARK Investment Management LLC, 2021.

Figure 2.4: ARK slide on Web3. Rights requested

computer scientists over the past decades to support that. From this base layer we also get the potential for secure and trust minimised identity management. This nascent field of distributed identity management is explained later. From distributed trust models we can see ‘trustless’ transmission of economic value. The ability to send value from one person to another person or service without a third party.

This whole area is ‘crypto’, which is increasingly seeping into the human consciousness, and saw an astonishing \$30B of capital investment in 2021 alone. At time of writing the industry is an over 1 trillion dollar market.

Of their 2022 ‘Big Ideas’ report, ARK investment LLC (who manage a \$50B tech investment) said the following (Figure 2.4), which connects some of the dots already mentioned, and leads us into the next section which is Blockchain and Bitcoin:

*“While many (with heavily vested interests) want to define all things blockchain as web3 we believe that web3 is best understood as just 1 of 3 revolutions that the innovation of bitcoin has catalyzed.*

- *The Money Revolution*
- *The Financial Revolution*
- *The Internet Revolution”*

All the new crypto technologies circling the Web3 narrative are bound tightly together, but there is currently very little meaningful value to be seen.

The rest of this book will focus on the trust and value transfer

elements of this shift in internet technologies, and attempt to build a case for it's use in decentralised, open source, metaverse applications.



### 3. DLT, Blockchain, and Bitcoin

Distributed ledger technology (DLT) is a data structure distributed across multiple managing stakeholders. A subset of DLT is blockchain, which is a less efficient, immutable data structure with a slightly different trust model. Rauchs et al. of the Cambridge Centre for Alternative Finance provide a detailed taxonomy and conceptual framework [5]. It can be seen in their paper that the definitions are somewhat unclear in literature.

DLT, and especially blockchain, are rapidly gaining ground in the public imagination, within financial technology companies (FinTech), and in the broader corporate world.

The technology and the global legislative response are somewhat immature, and misapplications of both technologies are commonplace.

Distributed trust models emerged from cryptography research in the 1970s when Merkle, Diffie, and Hellman at Stanford worked out how to send messages online without a trusted third party [6, 7].

Soon after the 1980s saw the emergence of the cypherpunk activist movement, as a reaction to the emerging surveillance state [8, 9]. These early computer scientists in the USA saw the intersectionality between information, computation, economics, and personal freedom [10]. Online discussion in the early nineties foresaw the emergence of trans-national digital markets, what would become the WWW [11, 12]. The issues of privacy and the exchange of digital value (digital /

### Bitcoin prehistory - It's the result of 40 years of research, development and demand



Figure 3.1: Dan Held: Bitcoin prehistory used with permission.

ecash) were of foremost importance within these discussions and while privacy was within reach thanks to “public/private key pairs”, ecash proved to be a more difficult problem.

Adam Back’s 1997 ‘hashcash’ [13] paved the way for later work by implementing the concept of what would become ‘proof of work’ [14, 15]. This was built upon by Dai [16], Szabo [17], Finney [18], and Nakamoto amongst others. In all it took 16 years of collaboration on the mailing lists (and dozens of failed attempts) to attack the problem of trust-minimised, distributed, digital cash. The culmination of these attempts was Bitcoin [19]. This is illustrated by Dan Held in Figure 3.1. This is now a wider ecosystem of technologies and societal challenges 3.2.

There is enormous complexity and scope, as seen in Figure 3.3, and yet genuinely useful products are elusive. It is surprisingly hard to pin down a simple explanation for the features which define a blockchain. These “key takeaway” from Investopedia are a neat summary however.

- *Blockchain is a specific type of database.*
- *It differs from a typical database in the way it stores information; blockchains store data in blocks that are then chained together.*
- *As new data comes in it is entered into a fresh block. Once the*



Figure 3.2: Bitcoin Topics used with permission @djvalerieblove.

*block is filled with data it is chained onto the previous block, which makes the data chained together in chronological order.*

- *Different types of information can be stored on a blockchain but the most common use so far has been as a ledger for transactions.*
- *In Bitcoin's case, blockchain is used in a decentralized way so that no single person or group has control—rather, all users collectively retain control.*
- *Decentralized blockchains are “append only”. In effect this means that the data entered becomes irreversible over time. For Bitcoin, this means that simple economic transactions are permanently recorded and viewable to anyone.*

In principle blockchains provide a **differentiated trust model**. With a properly distributed system a blockchain can be considered “trust-minimised”, though certainly not risk minimised. This is important for some, but not all people. There is not much emboldening of text within this book. If you start to question the whole reason for this ‘global technology revolution’ then it always comes back to those three words.

It can in fact be argued that the whole concept of distributed cryptographic blockchains is somewhat strained, as the vast majority of the technology offerings are not distributed, and worse, meaningful distribution may indeed be practically impossible without a trusted third party [20]. “There are many scenarios where traditional databases should be used instead”[21].



Figure 3.3: Intersecting disciplines. Reused with permission Dhruv Bansal

### 3.1 What's this for sorry?

The proponents of blockchains argue, that in an era when data breaches and corporate financial insolvency intersect with a collapse in trust of institutions, it is perhaps useful to have an alternative model for storage of data, and value. That seems like a lot of effort for a questionable gain. It's far more likely it's simply speculation.

While writing this book the questions of ‘what is this *really* for and how can it possibly be worth it’, came up again and again. In truth it’s a very difficult question, without a clear enough answer. It’s beyond the scope of this book to figure this out properly, but references to advantages and disadvantages will be made throughout.

It seems that the engineers who created Bitcoin wanted very much to solve a technical problem they saw with money (from their understanding of it), and the transmission of money digitally. As the scale and scope have increased so has the narrative evolved as seen in Figure 3.4, but it’s never really kept pace with the level of the questions posed.

A cost benefit analysis that excludes speculative gains seems to fail for pretty much all of blockchain/DLT. Bitcoin is more subtle as it

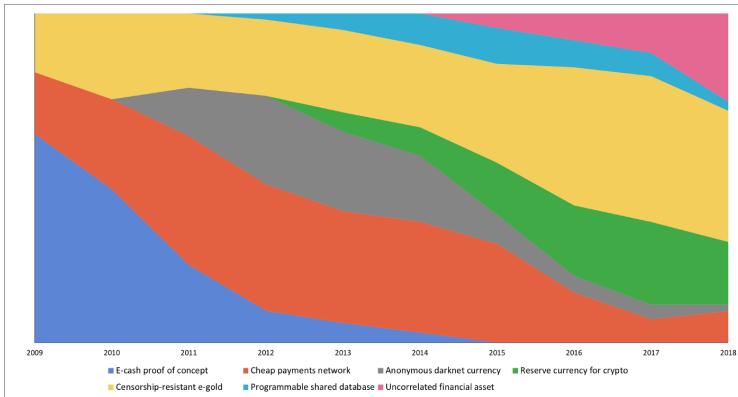


Figure 3.4: The narrative use of Bitcoin has evolved, by Nic Carter and Hasufly.

possibly *can* circumvent the legacy financial systems. This still leaves huge questions. To quote others in the space, is Bitcoin now the iceberg or the life raft?

For the most cogent defence of the technology as it stands in this moment, Gladstein (and others) offer a vision for the asset class, in the 87% of the world he says don't have access to the benefits enjoyed by the developed west [22] (Figure 3.5). He points to Block and Wakefield Research's report which finds those living under financially oppressive regimes are the most optimistic about the technology as in Figure 3.6. This argument is suggestive of huge and untapped markets for services which may be accessible to developed nations through telepresence/metaverse interfaces.

Gladstein's is a carefully developed and well researched book, but is written from the perspective of (just) Bitcoin 'being the raft'. Later in this book we will consider if it might be the iceberg, but this is not the domain expertise we offer in this book.

Raoul Pal of RealVision says: *Crypto adoption is now massively outperforming the internet. It's been growing at about 165% a year versus 85% for the internet for the same period of time now.* According to analytics company Chainalysis; growth is fastest in the Middle east and North Africa (Figure 3.7).

Thanks to a natural fit with strong encryption, and innate resistance to censorship by external parties, these systems do lend themselves well to 'borderless' applications, and are somewhat resistant to global

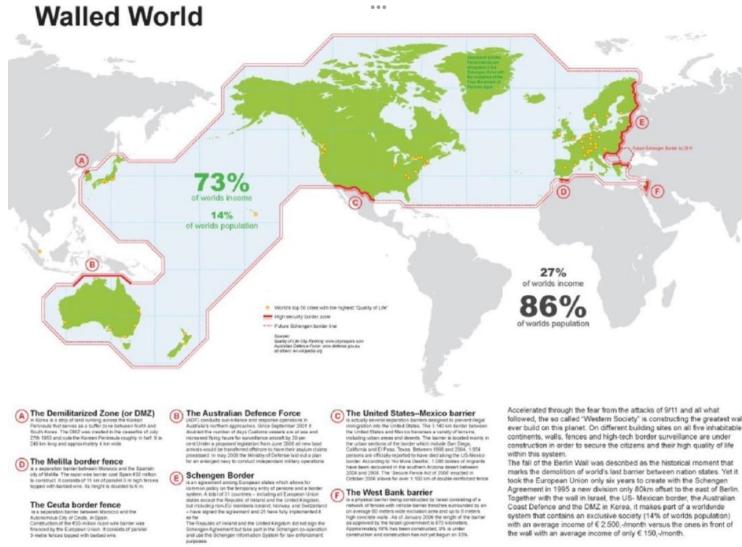


Figure 3.5: The world is divided along both economic and militaristic lines.

regulation (for good or ill). Given the rates of adoption seen in Figures 3.7, 3.9, and 3.8 it seems that this stuff is coming regardless of their usefulness to the developed world. This provides us an excellent use case to explore for metaverse applications, and this will be the focus.

## 3.2 A panoply of tech

Within DLT/blockchain there seem to be as many opinions on the value of the technology as there are implementations. A host of well engineered open source code repositories makes the cost of adoption relatively low.

There are thousands of different ‘chains’ and many more tokens which represent value on them. A majority of these are code forks of earlier projects. Most are defunct yet still have some residual ‘value’ locked up in them as a function of their ‘distributed’ tokens.

Because the space is comparatively new, subject to scant regulation, and often open source, it is possible to clone a github, change a few lines of code, and front it with a website in order to create ‘scams’, and this happens frequently [23].

The following sections give an overview of the major strands of the

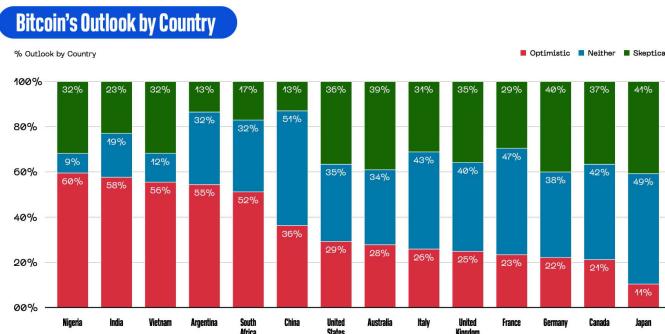


Figure 3.6: “This new chart from Block is financial privilege visualized.”

technology. First is Ethereum, mainly to discount it’s use for our needs, and move on to more appealing options.

### 3.3 Ethereum

Ethereum [24] is the second most secure public blockchain (by about 50%)[25], and second most valuable by market capitalisation (though this comparison is somewhat stretched). It is the natural connection from Web3 to the rest of the book, so it will be considered first.

It is touted as ‘programmable money’. It, unlike bitcoin, is (nearly) Turing complete [26], able to run a virtual machine within the distributed network (albeit slowly), and can therefore process complex transactional contracts in the settlement of value. This has given rise to the new field of ‘distributed finance’, or DeFi (described later), alongside many interesting trust-minimised immutable ledger public database ideas.

There are trade-offs and problems with Ethereum (Eth/Ether) which currently increase the ‘participation floor’ and make the network far less suitable for entry level business-to-business use. The ledger itself being a computational engine, with write only properties, is enormous. Specialist cloud hardware is required to run a full node (copy of the ledger), and partial nodes are the norm. Many partial nodes are run by one specialist cloud provider (Infura), which has recently been forced to exclude Venezuela from the network. Network validators are

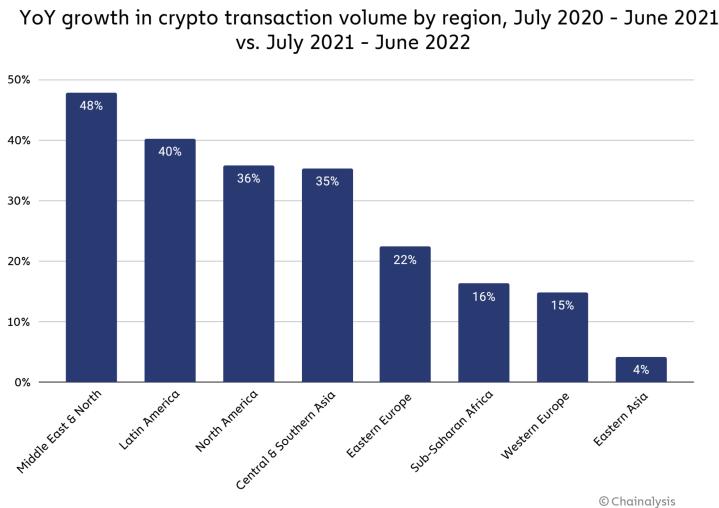


Figure 3.7: Rapid growth is mainly outside of ‘Western Markets’

refusing to process addresses on an OFAC sanction list. A staggering 58% runs on Amazon AWS servers. Critics of the project point to these vulnerabilities to outside influence as an existential threat to the aims of the technology. If it can be censured, then what advantage is there over the founders simply running a high speed database to the same purpose?

This is a function of the so called ‘scalability trilema’ [27], in which it seems that only two features from the list of decentralization, scalability or security can be chosen for blockchains [28].

Moreover the network is centrally controlled by its creator and the ‘miners’. There is a strong case to answer that Eth is neither distributed, nor trustless, and in fact therefore fails to be differentiated from a DLT, undermining some of its claims. The history of Ethereum is a fascinating case study in human greed. By the time the whitepaper had its first limited release, Bitcoin (covered next) had already passed \$1000 per token. This led to the creators ambitions for a ‘fair release’ of tokens being voted down by powerful funders, leading to the explosion of similarly structured ‘pre-mined’ coins in the ICO craze, which followed on the Ethereum network. Laura Shin is possibly the most experienced journalist and author in the space and has covered this

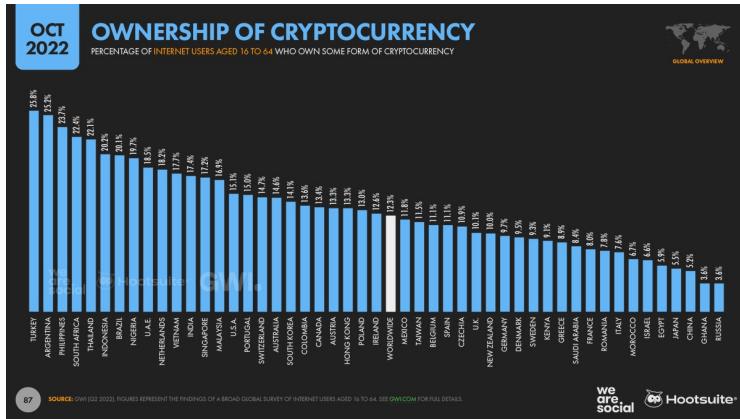
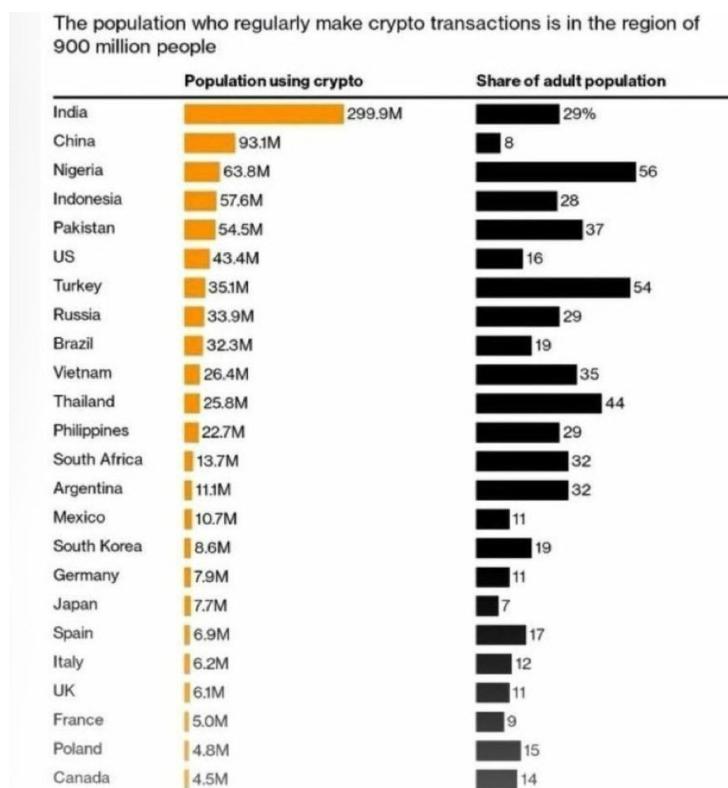


Figure 3.8: Rapid growth is mainly outside of ‘Western Markets’ - 2

crazy era in her book ‘The Cryptopians’ [29]. It’s a tough read for the newcomer though, perhaps finish this primer first!

With that said there are many talented developers doing interesting work on the platform, and innovation is fast paced. It is entirely normal for technology projects to launch their distributed ledger idea on and within the Ethereum network. These generate tradable ‘ERC-20’ tokens, which can accrue value or demonstrate smart contract utility (based on the *Solidity* programming language). Because the value locked and generated in the Ethereum platform comes not just from the ETH token, but all the ERC technologies built upon it, there are hundreds of billions of pounds ‘within’ the network. All of these projects, and indeed the core technology of Ethereum are subject to exploits and vulnerabilities and tens of billions of pounds have been lost [30]. Most of this money is pure market speculation (as is the case across blockchains). Many analysts cannot see this as anything but a speculative bubble, with all the predictable crash yet to come. This can be seen in the context of other bubbles in Figure 3.10. It seems that most of the projects in crypto more generally, but certainly with ETH and the NFTs within it are a new kind of social gambling, where online communities can reinforce groupthink around their speculative choices. Jason Lowery of MIT and US Space Force lays out a very clear thesis on the difference between Natamoto consensus and most of what followed as part of his PhD. His explanation here is one of the reasons why we focus on Bitcoin, and dismiss ‘proof of stake’ models:



Source: Morning Consult, World Bank, Bloomberg Opinion calculations

Note: Based on people who have made crypto transactions at least once in the past month.

BloombergOpinion

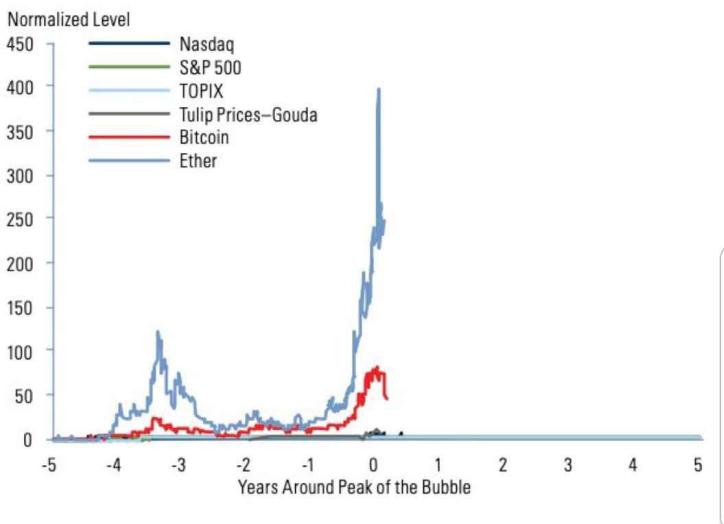
Figure 3.9: Regular user numbers are surprisingly high.

*"The innovation behind PoW is precisely the fact that it **doesn't** rely exclusively on software (an abstraction) to keep the ledger systematically secure, but instead incorporates real-world physics (watts) to impose real-world physical constraints on people/computers who run it. Stake is an abstraction. It is an imaginary way to describe the complex emergent behaviour of a bunch of general-purpose state machines. The state machines may physically exist, but the way you choose to visualize the complex emergent behaviour of those machines is imaginary. Satoshi didn't couple control authority over ledger to abstract, imaginary things like 'stake' or 'coin' precisely because these things don't physically exist. If they don't physically exist, they are*

### Ether in the Context of Equity Market

#### Bubbles, Bitcoin and Tulips

The equity, tulip and Bitcoin bubbles are all dwarfed by the price moves in Ether.



Data through May 31, 2021.

Source: Investment Strategy Group, Bloomberg.

Figure 3.10: Ethereum is thought to look like a speculative bubble.  
Rights requested

*incapable of imposing real-world physical costs on people seeking control of ledger. The real-world physical cost of controlling the ledger is what keeps control over the ledger decentralized. It is too physically expensive (in watts) to gain and maintain centralized control over the BTC ledger. In proof of stake, there is no physical cost of gaining centralized control. Why? Because stake doesn't physically exist. So all it takes to gain centralized control is majority stake. And once you have it (which, because of math, some combination of people already do), you have it forever.*

With all this said most of the couple of million people who have used NFTs use Ethereum, and if this market of creators and consumers is to be brought into a mixed reality space then they will need a way to bring their objects with them. Such is the level of nefarious activity on

these networks (within Ethereum) that they have a poor reputation, and are difficult to audit, launch, and maintain. The overriding problem of using a blockchain for utility applications (rather than just as money) is that people can, and will, simply lie for criminal purpose when entering data into the ledger. It is far more likely that Ethereum is simply a speculative bubble than any of the claims for utility being born out. Add to that Morgan Stanley's recent assertion that Ethereum is itself threatened by newer contender chains and its future becomes unclear. The report correctly identifies that "High transaction fees create scalability problems and threaten user demand. High costs make Ethereum too expensive for small-value transactions.". It is this high cost of use that most excludes the ERC-20 networks from our consideration.

### **3.3.1 Gas fees**

Ethereum has a significant barrier to entry because of high fees to use the network. The system is Turing complete; able to programmatically replicate any other computational system. This includes endless loops in code, so it is trivial to lock up the computational bandwidth of the whole system, in a smart contract commitment, through a web wallet.

To mitigate this existential 'denial of service attack' the 'gas' system demands that users spend some of their locked up value to operate on the network. In this way a transaction loop would quickly erode the available gas and stop looping. As the popularity of the system has grown, so too have the gas fees. It can sometimes cost over £10,000 to do a single transaction, though it is typically a few tens of pounds. Appallingly if the user pitches their mining fee offer too low, then the money gets spent anyway! A website just plucks random Ethereum addresses out of the aether to show you the level of this expense for participants. People can even buy NFTs of the worst examples of these, as 'tokens', wasting more money. This is a huge problem for potential uses of the network.

### **3.3.2 Ether ultra hard money narrative**

Part of the challenge Ethereum faces is wrapped up with its complex token emission schedule. This is the rate at which tokens are generated and 'burnt' or destroyed in the network. The total supply of tokens is uncertain, and both emission and burn schedules are regularly tinkered with by the project. The changes to the rate at which ETH are generated can be seen in Figure 3.11. In addition, a recent upgrade (EIP-1559)

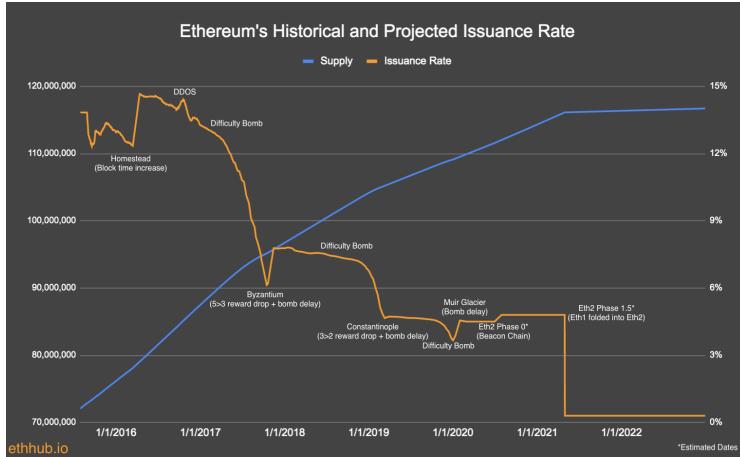


Figure 3.11: The rate of token generation has changed unpredictably over time. Rights requested

results in tokens now being burnt at a higher rate than they are produced, deliberately leading to a diminishing supply. In theory this increases the value of each ETH on the network at around 1% per year. It's very complex, with impacts on transaction fees, waiting time, and consensus security, as examined by Liu et al. [31]. Additionally, there is now talk (by Butlerin, the creator of Ethereum) of extending this burn mechanism further into the network.

Ethereum was designed from the beginning to move to a ‘proof of stake’ model where token holders underpin network consensus through complex automated voting systems based upon their token holding. This is now called Ethereum Consensus Layer. This recent ‘Merge’ upgrade has reduced the carbon footprint of the network, a laudable thing, though it seems the GPUs and datacentres have just gone on to be elsewhere. It has not lowered the cost to users nor improved performance. As part of the switching roadmap users were asked to lock up 32ETH tokens each (a substantial allocation of capital). In total there are around 14 million of these tokens, and it is those users who now control the network. This money is likely stuck on the network until at least 2024, a significant delay when compared to the original promises.

This means that proof of stake has problems in that the majority owners ‘decide’ the truth of the chain to a degree, and must by design

have the ability to over-ride prior consensus choices. Remember that these users are now trapped in their positions. Four major entities now control the rules of the chain, and have already agreed to censor certain banned addressees. Proof of stake is probably inherently broken [32]. This has for malicious actors who have sufficient control of the existing history of the chain, thought to be in the region of \$50M [33]. Like much of the rest of ‘crypto’ the proposed changes will concentrate decisions and economic rewards in the hands of major players, early investors, and incumbents. This is a far cry from the stated aims of the technology. The move to proof of stake has recently earned it the MIT breakthrough technology award, despite not being complete (validators cannot yet sell their voting stakes). It’s clearly a technology which is designed to innovate at the expense of predictability. This might work out very well for the platform, but right now the barrier to participation (in gas fees) is so high that we do not intend for Ethereum to be in scope as a method for value transfer within metaverses.

### **3.4 Bitcoin**

The first blockchain was the Bitcoin network [19], some two decades after Haber et al. first described the idea [34]. Prior to Bitcoin these structures were called ‘timechains’ [35]. It can be considered a triple entry book keeping system [36, 37], the first of its kind, integrating a ‘provable’ timestamp with a transaction ledger, solving the “double spend problem” [38, 39, 40]. Some see this as the first major innovation in ledger technology since double entry was codified in Venice in fourteen seventy five[41].

It was created pseudonomously by an individual or group calling themselves ‘Satoshi Nakamoto’ in 2009, as a direct response to the perceived mishandling of the 2008 global financial crisis [35], with the stated aim of challenging the status quo, with an uncensorable technology, to create a money which could not be debased by inflation policy, and outside of the politically captured fintech incumbents. It’s interesting to note that the narrative around the use case for Bitcoin has shifted over its lifetime.

The “genesis block” which was hard coded at the beginning of the ‘chain’ contains text from The Times newspaper detailing the second bank bailout.

There will only ever be (just short of) 21 million bitcoins issued, of which around 19 million have already been minted, and around 4 million lost forever. This ‘hard money’ absolute scarcity is a strong

component of the Bitcoin meme landscape. These are basically arbitrary figures though; a combination of the issuance schedule, and an ‘educated guess’ by Nakamoto: [35]

*"My choice for the number of coins and distribution schedule was an educated guess. It was a difficult choice, because once the network is going it's locked in and we're stuck with it. I wanted to pick something that would make prices similar to existing currencies, but without knowing the future, that's very hard. I ended up picking something in the middle. If Bitcoin remains a small niche, it'll be worth less per unit than existing currencies. If you imagine it being used for some fraction of world commerce, then there's only going to be 21 million coins for the whole world, so it would be worth much more per unit."*

In theory there is no barrier to access, and equality of opportunity to accumulate and save over long periods. This is not true of chains and tokens since, which lock up some of their value for seed investors to cash out later. None of the blockchains since are decentralised in the same way [42]. Bitcoin was probably a singular event.

Each Bitcoin can be divided into 100 million satoshis (sats), so anyone buying into Bitcoin can buy a thousandth of a pound, assuming they can find someone willing to transact that with them.

Satoshi Nakamoto (the name of the publishing entity) disappeared from the forums forever in 2010. Bitcoin has the marks of cypherpunks and anarcho capitalism. The IMF has recently conceded that the Bitcoin poses a risk to the traditional financial systems, so it could be argued that it is succeeding in this original aim.

Although there were some earlier experiments (hashcash, b-money etc), Bitcoin is the first viably decentralised ‘cryptocurrency’; the network is used to store economic value because it is judged to be secure and trusted. It is a singular event in that it became established at scale, such that it could be seen to be a fully distributed system, without a controlling entity. This is the differentiated trust model previously mentioned. This relative security is the specific unique selling point of the network. It is many times more secure than all the networks which came after based on a like for like comparison of transaction ‘confirmations’. This network effect of Bitcoin is a compounding feature, attracting value through the security of the system. It is deliberately more conservative and feature poor, preferring instead to add to its feature set slowly, preserving the integrity of the value invested in it over the last decade. At time of writing it is a top quartile largest global currency and has settled over \$13 trillion Dollars in 2021, though Makarov et al. contest this, citing network overheads, and speculation

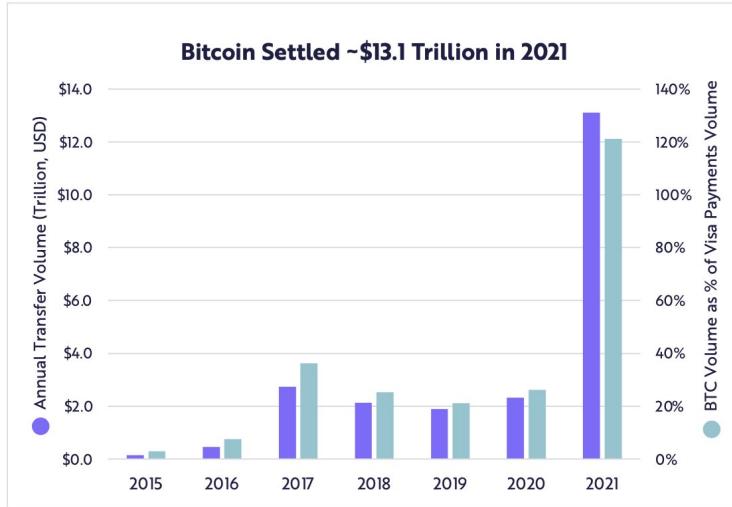


Figure 3.12: Growth in settlement value on the Bitcoin network (Forbes).

[43]. Institution grade ‘exchange tradable funds’ which allow investment in Bitcoin are available throughout the world, and the native asset can be bought by the public easily through apps in all but a handful of countries as seen in Figure 3.12.

Only around 7 transactions per second can be settled on Bitcoin. The native protocol does not scale well, and this is an inherent trade-off as described by Croman et al. in their positioning paper on public blockchains [44]. Over time, competition for the limited transaction bandwidth drives up the price to use the network. This effectively prices out small transactions, even locking up some value below what is a termed the ‘dust limit’ of unspent transactions too small to ever move again [45].

Bitcoin has developed quickly, with a faster adoption than even the internet itself. It is already a mature ecosystem, with enterprise grade software stacks, and is seeing adoption as a corporate treasury asset.

Adoption by civil authorities is increasing, and legislators the world over are being forced to adopt a position. California has an explicitly Web 3 and blockchain executive order to investigate and support opportunities. Many city treasuries have added it to their balance sheet. Honduras has launched “Bitcoin Valley” as a tourist initiative, and the

Swiss city of Lugano is launching a huge initiative alongside Tether. It is already legal tender in the country of El Salvador[46] and the Central African Republic, and will be soon in Madeira and Roatán island. This means it *must* be accepted as a means of payment. CAR are also launching their own Bitcoin sidechain (like Liquid described later) as a pan African initiative. In places such as Panama it simply has legal status and *can* be accepted without double taxation.

Global asset manager “Fidelity” wrote the following in their 2021 trends report. *“We also think there is very high stakes game theory at play here, whereby if Bitcoin adoption increases, the countries that secure some bitcoin today will be better off competitively than their peers. Therefore, even if other countries do not believe in the investment thesis or adoption of bitcoin, they will be forced to acquire some as a form of insurance. In other words, a small cost can be paid today as a hedge compared to a potentially much larger cost years in the future. We therefore wouldn’t be surprised to see other sovereign nation states acquire bitcoin in 2022 and perhaps even see a central bank make an acquisition.”*

### 3.4.1 The Bitcoin Network Software

There isn’t a single GitHub which can be considered the final arbiter of the development direction, because it is a distributed community effort with some 500 developers out of a wider ‘crypto’ pool of around 9000 contributors (the vast majority are spread across disparate Ethereum and some Solana projects). Development and innovation continues but there is an emphasis on careful iteration to avoid damage to the network. Visualisation of code commitments to the various open source software repositories can be seen at Bitpaint youtube channel and in Figure 3.13.



Figure 3.13: Bitpaint: Contributions to the Bitcoin ecosystem. Reused with permission.

Bitcoin core is the main historical effort (with around a dozen major contributors guiding the direction), but there are alternatives (LibBit-

coin in C++, BTCD in Go, and BitcoinJ in Java), and as innovation on layer one slows, attention is shifting to codebases which interact with the base layer asset. Much more on these later.

### **3.4.2 Mining and Energy concerns**

#### **3.4.2.1 Mining process overview**

Bitcoin mining is the process of adding public transactions into the ledger, in return for two economic rewards, paid in Bitcoin. These are the mining fee, and the block reward. The transactions which are added into the next ‘block’ of the chain are selected preferentially based on the fee they offer, which is up to the user trying to get their transaction into the chain. This can be within the next 10 minutes (next block), or a gamble out toward ‘never’ depending how competitive the network is at any time. Miners try to find a sufficiently low result from a cryptographic hash function [47](a random process), and upon finding it, they can take their pre-prepared ‘block’ of transactions sourced from their local queue (mempool), and add it into the chain, for confirmation by other miners. In return they take all the fees within that mined block, and whatever the block reward is at the time. When the network started the block reward was 50 Bitcoin, but has halved repeatedly every 210,000 blocks (four years) and now stands at 6.25 BTC. The rate of mining is kept roughly at one block every 10 minutes, by a difficulty adjustment every 2016 blocks (2 weeks). This is a complex interdependent mechanism and is explained very well in [this article](#). These components are explained in slightly more detail later.

#### **3.4.2.2 Energy & policy response**

Bitcoin uses a staggering amount of energy to secure the blockchain (Figure 3.14), and this has climate repercussions. A simple back of the envelope use of the IEA total energy supply, and the Cambridge Bitcoin energy use estimate puts the network at around 0.1% of global energy use.

It is an industrial scale global business with ‘mining companies’ investing hundreds of millions of pounds at a time in specialist ASIC mining hardware and facilities. The latest purpose designed Intel chip touts both Web3 and metaverse applications. This is “proof of work”, and is essential to the technology, and is still thought by some to be the best available option. The Cambridge Bitcoin Energy Consumption Index monitors this energy usage. Their 2022 report sees American mining leading globally.

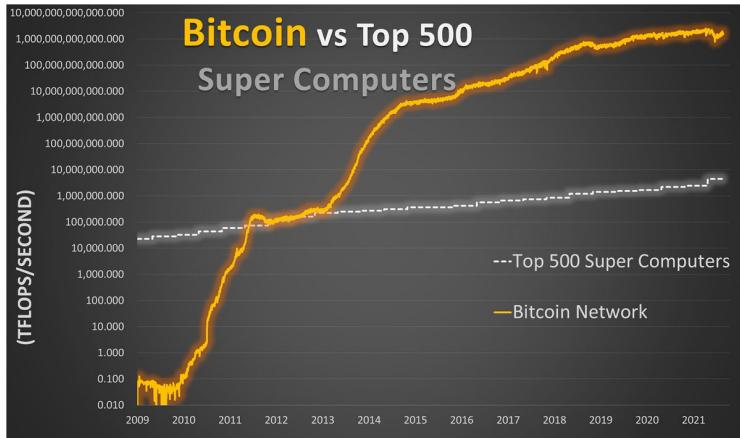


Figure 3.14: Bitcoin network vs TOP500 supercomputers

At the end of 2022 it is thought to be the case that the only profitable miners are the large scale companies who are also providing load balancing services to energy companies. This is unusual in the history of mining, and the situation will likely change over time. This is not to say that all mining is, or should be, so concentrated. Anyone running the hashing algorithm can get lucky and claim the block reward. PoW ties the value of the ‘money’ component of Bitcoin directly to energy production. This is not a new idea. Henry Ford proposed an intimate tie between energy and money to create a separation of powers from government, as can be seen in Figure 3.17. The potential ecological footprint of the network has always been a concern; Hal Finney himself was thinking about this issue with a mature Bitcoin network as early as 2009, and a debate on the Bitcoin mailing lists called the mining process “thermodynamically perverse”. The most cited negative analysis on the matter by Mora et al sees Bitcoin mining alone warming the planet above 2 degrees [48].

Proponents of the technology say that the balance shifted dramatically in 2021 with China outright banning the technology; this has forced the bulk of the energy use toward the USA, and away from ‘dirty coal’ as seen in Figure 3.18. Some adherents have proposed mitigations [49]. As a worked example of Cross and Bailey’s proposal a retail investor owning 1 BTC would have to buy around 700 shares of ‘CleanSpark’ mining company (CLSK) to make their holding completely neutral. Some more strident voices suggest that ‘ending

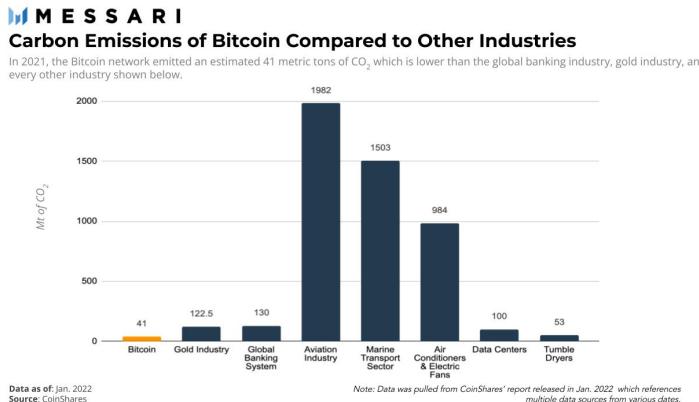


Figure 3.15:

financialisation' through use of Bitcoin may be net positive for the environment at a macro level [50]. Indeed it may provide a route to support electrifying everything through deployment of flexible demand load. This enables a kind of 'financial battery' that can soak up excess capacity from overbuilt renewables (something which needs to be done).

Some projects are using the financial incentive of Bitcoin to enable trials of new infrastructure. For instance; Makai Ocean engineering have partnered with Oceanbit Hawaii to trial 'ocean thermal energy conversion' as a possible power source for the Islands. Local subsidy initiatives may begin to drive this kind of adoption as seems to be happening in Texas[51, 52]. Brad Jones, interim CEO of the Texas grid said:

*"As we get more renewable generation, in particular wind [which] is operating at night ... we have to find a home for it, otherwise we have to turn the wind down. It's such a great resource we shouldn't turn it down. Bitcoin mining or what some call crypto has found a way to come into our markets and take some of that wind in off-peak periods. Then when we get to peak period times they are very quick to remove themselves from the market as prices increases. The fact that we can turn down whenever we need the power for other customers is fantastic. We can use that crypto currency to soak up that excess generation when there's a lot of that, and find a home for more solar and more wind to come to our grid. Then they reduce consumption"*

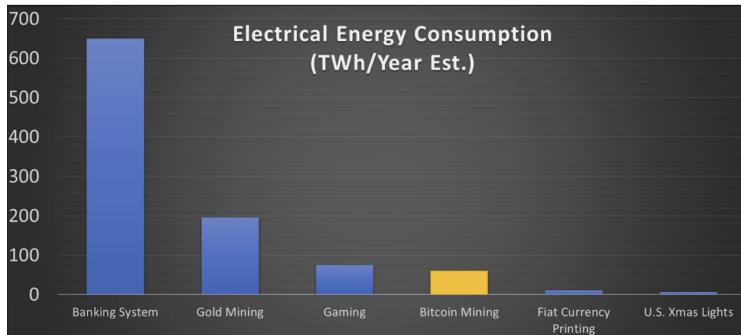


Figure 3.16: Bitcoin Magazine

*when we need that power for other customers. So it's a great balancing act. Most other datacenters [such as] Microsoft or Amazon have other customers to serve every other day, so they can't just turn off. But these crypto customers can. If the cost of energy gets too high they can remove themselves from the market. They are also helpful if we lose a generator. They can quickly respond to that frequency disruption and allow us to balance our grid."*

This “global energy market revolution” is explained by Tabatabai of Modo Energy.

There is growing interest and adoption of so called “stranded energy mining” which cannot be effectively transmitted to consumers, and is thereby sold at a huge discount while also developing power capacity, without the usual constraints [53]. One such example is “Gridless” in Kenya, which seeks to harness abundant green energy resources in rural areas with the hope of kick-starting economic growth. In addition to new build it is possible to re-purpose historic infrastructure, and/or reducing the carbon (or more interestingly the methane) of existing infrastructure. Adam Wright of Vespene Energy says: “*You could either mine Bitcoin on one small landfill for a year, or you could plant 5 million trees and let them grow for 10 years - both of those are going to have the same environmental impact.*”

Cheikosman, a policy analyst for the World Economic Forum (somewhat surprisingly) wrote “*Crypto is becoming an essential part of developing a carbon-neutral energy grid and has made it economically viable to invest in, develop and build renewable energy power generation.*” The market economics of this are far from simple, but are well explained by Connell in a podcast.



Figure 3.17: Intimate tie between energy and money, Henry Ford

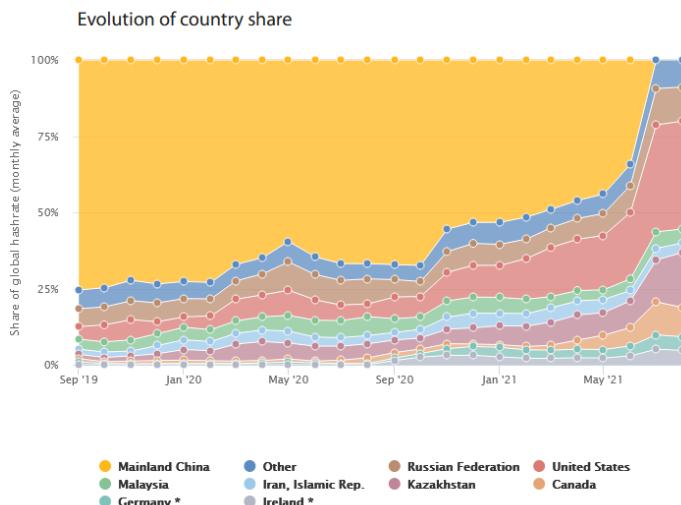
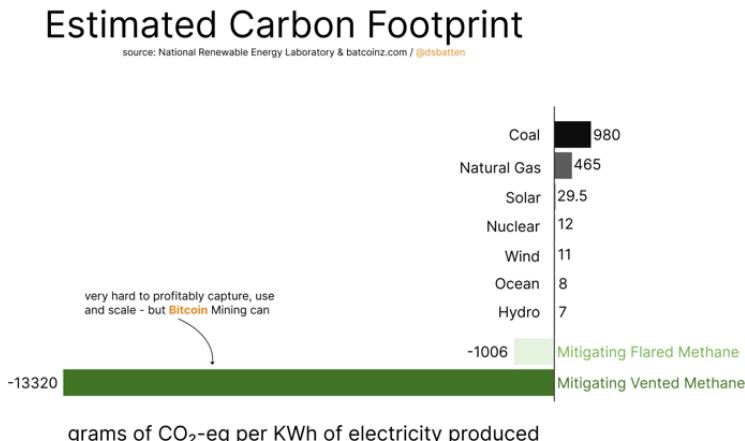


Figure 3.18: Hash rate suddenly migrates from China [Reuse rights requested]



**Figure 3.19:** Climate tech investor Daniel Batten asserts that methane capture could highly impactful

The most cited example of building capacity before grid connection is El Salvador’s ‘volcano mining’ proposal, which is supporting their national power infrastructure plans. Uzbekistan seems to be promoting a similar model with zero tax provided the Bitcoin mining companies build out their own solar infrastructure. A more poignant example is the Mechanicville hydro plant in the USA. The refurbishment of this 123 year old power plant is being funded by Bitcoin mining. This is the “buyer of last resort” model first advanced by Square Inc.

Conversely it might be that vertical integration of Bitcoin mining within legacy fossil fuel stations gives them a new lease of life. New York State has dealt with this kind of threat by imposing a moratorium on new, fossil fuel powered mining activity. On a global stage something as portable and industrial as Bitcoin mining will have unintended impacts on fragile energy systems, as has happened in South Ossetia and Kazakhstan (note Russia has stepped into this mess). Undeniably the consensus position is that it’s overall very negative, (with some caveats) and this will *probably* persist. Perhaps though if it’s happening anyway, then finding utility of the asset might mitigate the net harm.

More pragmatically, Baur and Oll found that “*Bitcoin investments can be less carbon intensive than standard equity investments and thus reduce the total carbon footprint of a portfolio.*”[54]. Perhaps of note

for the near future is that KPMG whose investment was mentioned in the introduction also matched their position in the space with equivalent carbon offsets. This may provide an investment and growth model for others.

The power commitment to the network is variously projected to increase, or level off over time. The emission schedule of the code suggests that the energy usage will decrease exponentially over time. It's one of the maddening unknowns of the technology how this will all pan out. The industry now argues that economic pressures mean that most of the 'hashrate' is generated by renewable energy[55]. As a recent example of this trend Telsa (Elon Musk), Block (Twitters Jack Dorsey), and Blockstream (Adam Back) are teaming up to mine with solar energy in Texas.

Paez and Cross prepared a paper for the White House Office of Science and Technology Policy, submitted through the Bitcoin Policy Institute, which is a growing thinktank for academics and industry leaders. Their summary points echo the assertions made here, but they provide rich additional referencing for those who wish to dig deeper into this:

- *Bitcoin's value—its economic value and promotion of American values and American national interests—must frame any discussion of its environmental impact.*
- *Bitcoin's value is inherently tied to its consensus mechanism: proof of work.*
- *While bitcoin mining is energy-intensive, its energy use is often overestimated and improperly characterized as a function of transaction volume.*
- *Due to bitcoin's exponentially decreasing schedule of issuance, mining's actual emissions are likely to peak at under 1% of global emissions, even if prices rise more than tenfold within the decade.*
- *Mining's profile as a consumer of energy is unique: extremely cost-sensitive, and invariant across times and locations.*
- *Bitcoin mining, as a buyer of first and last resort, incentivizes the buildup of renewable power production. As a controllable load resource (CLR) bitcoin mining also strengthens the grid, allowing it to reliably function at a high level of renewable penetration.*
- *Mining's energy use is increasingly non-rival, trending towards a diet of renewables and stranded, wasted energy resources such*

*as flared methane.*

The debate whether this consumption is ‘worth’ it is complex and rapidly evolving. Useful examples of this are:

- the online pushback to an academic article by PhD candidate de Vries et al. [56]
- the assertion that the widely cited Mora et al. paper in Nature [48] was based on an undergraduate class discussion, and has had an outsized effect on global policy.
- a paper from the Bitcoin Policy Institute,
- and the industry open letter to the EPA.
- this well considered Twitter thread by climate scientist Margot Paez.

It is somewhat confusing that positive views are coming only from diverse and non-specialist voices in the community, and never the academic community, but the shortcomings they point out in the supposedly considered articles such as Mora et al [48] are easily verified. Academia seems poorly positioned to pivot to this subject, as an ethical bar has to be established before research can commence, and the field is too new to make this an affordable task. This stuff is existentially important to the whole technology. Is a trillion dollar asset which potentially replaces the money utility of gold, but doesn’t need to be stored under guard in vaults (Figure 3.20), worth the equivalent power consumption of clothes dryers in North America? Probably not with the current level of adoption, but this is an experiment in replacing global money. If that were to happen then Bitcoin would be around 50 times more efficient than the current system according to Khazzaka [57]. To be clear it’s not the position of this book that replacing Fiat money is a good idea, but the experiment is being run regardless. This is explored in it’s own chapter later.

It seems possible that four value propositions are therefore emerging:

- Bitcoin the speculative asset (or greater fool bubble [58]). Nations such as the USA, who own 30% of the asset have bid up the price of the tokens during a period of very cheap money, and this has led to a high valuation for the tokens, with a commensurately high network security through the hash rate (mining). This could be a speculative bubble, with the asset shifting to one of the other valuations below. There is more on this subject in the money section later.
- Bitcoin the monetary network, and ‘emerging market’ value transfer mechanism. There is no sense of the “value” of this

network at this time, but it's the aspect we need for our metaverse application. For this use the price must simply be high enough to ensure that mining viably secures the network. This security floor is unfortunately a 'known unknown'. If a global Bitcoin monetary axis evolves (as in the Money chapter later) the network would certainly require a higher rate than currently, suggestive of a higher price of token to ensure mining.

- Bitcoin as a flexible load in power distribution systems, and methane mitigation 'asset'. Again there is no price against this, but we can perhaps grossly estimate it at around half the current hash rate if 50% of the network is currently green energy. This would imply a price for the asset roughly where it is now (ie, not orders of magnitude higher or lower).
- Amusingly Ben Hunt suggests in an online article that the true value of Bitcoin can be couched in terms of it's value simply as 'art'. The posits that at this time the narrative is simply so seductive and powerful that people (being people) are choosing to value their involvement in the economics of the space as they might a work of art. It's a fascinating idea, and intuitively, probably it's right.

Legislators globally, are starting to codify their positions on proof of work as a technology (including Bitcoin). The USA is variously supporting or constricting the technology, according to state legislatures. Notably New York has banned new carbon intensive mining facilities for 2 years, while rust and farm belt states with energy build-out problems are providing incentives. At the federal level the recent "Climate and energy implications" report is parts positive and parts negative about proof of work, and leaves the door open to a legislative clampdown. Carter provides a detailed response to the tardy scientific analysis in the report. It does seem to admit that there is a knowledge gap, and essentially suggests more research. Perhaps most interestingly it notes the potential of methane mitigation as mentioned earlier. It is conceivable that methane mitigation alone could provide a route forward for the technology. The report says: "*The crypto-asset industry can potentially use stranded methane gas, which is the principal component of natural gas, to generate electricity for mining. Methane gas is produced during natural gas drilling and transmission, and by oil wells, landfills, sewage treatment, and agricultural processes. Methane is a potent GHG that can result in 27 to 30 times the global warming potential of CO<sub>2</sub> over a 100-year time frame, and is about 80 times as powerful as CO<sub>2</sub> over a 20-year timeframe. Reducing methane*

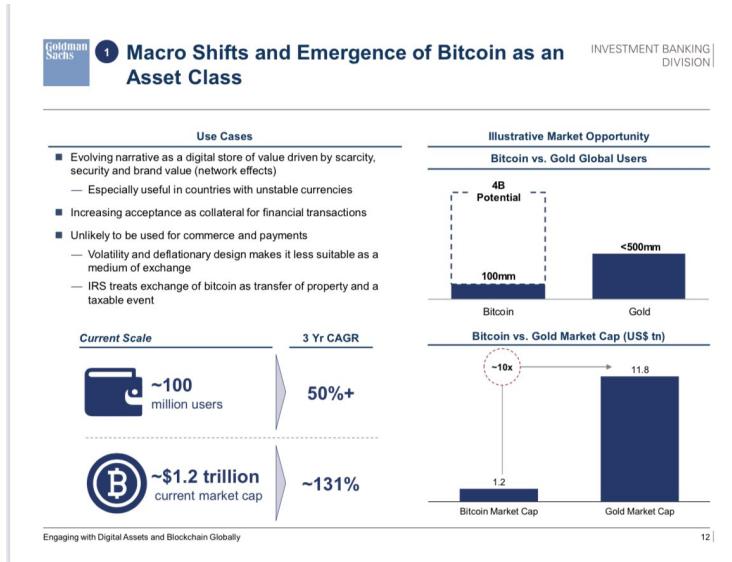


Figure 3.20: Goldman suggest growth opportunity and potential demonetisation of gold?

*emissions can slow near-term climate warming, which is why the Biden-Harris Administration released the U.S. methane emissions reduction action plan in 2021. Venting and flaring methane at oil and natural gas wells wastes 4% of global methane production. In 2021, venting and flaring methane emitted the equivalent of 400 million metric tons of CO<sub>2</sub>, representing about 0.7% of global GHG emissions. This methane is vented or flared, because of the high cost of constructing permanent pipelines or electricity transmission that could transport the methane or its potential electricity generation from remote oil and gas operations to end-users, or because of the high cost of installing equipment on older landfills. Crypto-asset companies are now exploring ways to use electricity generation from vented and flared methane at oil and gas wells and at landfills. While the EPA and the Department of the Interior have proposed new rules to reduce methane for oil and natural gas operations, crypto-asset mining operations that capture vented methane to produce electricity can yield positive results for the climate, by converting the potent methane to CO<sub>2</sub> during combustion. Mining operations that replace existing methane flares would not likely affect CO<sub>2</sub> emissions, since this methane would otherwise be flared*

*and converted to CO<sub>2</sub>. Mining operations, though, could potentially be more reliable and more efficient at converting methane to CO<sub>2</sub>. While such operations can reduce wasted methane, another option is low-cost recovery of methane using existing vapor capture technologies at oil and gas wells, which can reduce global methane emissions up to 50% by 2030.”*

The EU has just voted to add the whole of ‘crypto’, including PoW, to the EU taxonomy for sustainable activities. This EU wide classification system provides investors with guidance as to the sustainability of a given technology, and can have a meaningful impact on the flows of investment. With that said the report and addition of PoW is not slated until 2025, and it is by no means clear what the analysis will be by that point. Meanwhile they’re tightening controls of transactions, on which there will be more detail later. For it’s part the European Central Bank has come out in favour of strong constraints on crypto mining. They use the widely discredited “digiconimist” estimates to assert that mining operations are disproportionately damaging to the environment.

We have seen that China has cracked down hard on the technology, banning mining and pressuring holders of the assets. They have unwound this somewhat, and based on past experience it seems that they will continue to nuance their position as they seek adoption of their own digital currency. As much as 20% of all mining activity is now suspected to take place within China.

In India there has been confusion for years as more “local” law vies with confusing central government signalling. It has variously been banned and unbanned, and is now subject to punitive tax. The central bank of India is strongly in favour of a complete ban. Ajay Seth, secretary of the Finance Ministry’s Department of Economic Affairs recently said “*We have gone through a deep dive consulting with not just the domestic and institutional stakeholders but also organizations like IMF and World Bank.... Simultaneously we are also beginning our work for some sort of a global regulation (to determine) what role India can play... Whatever we do, even if we go to the extreme form, the countries that have chosen to prohibit, they can't succeed unless there is a global consensus”*

It feels like a global political response is just around the corner, but reputable voices in the community suggest that it always feels this way. There is more detail on this in Money chapter later in the book.

### 3.4.3 Technical overview

This section could be far more detailed, but this is pretty complex stuff. Instead, there's plenty of books and websites that do a more thorough job, if the reader is interested. Each subsection will include a good external link where more depth can be found. This whistle stop tour of the main components of the protocol should provide enough grounding, but it's not essential reading for non technical readers.

#### 3.4.3.1 ECDSA / SHA256 / secp256k1

These technologies tend to use the same underpinning elliptic curve cryptography, and it makes sense to unpack this here just once, only in the context of Bitcoin, as this will be the main focus of our attention.

Public keys are a huge number used in conjunction with an algorithm to encrypt data. This allows a remote party to interact with an actor on the network whose private keys can decrypt that same data.

In Bitcoin the ECDSA algorithm is used on the `secp256k1` elliptic function to create a trapdoor. This (essentially) one way mathematical operation was originally the “discrete log problem” and part of the research in cryptography by Diffie and Hellman [6]. This is what binds the public and private keys in a key pair (the foundation of the whole space).

In their mathematical construct a modulus operator creates an infinite number of possible variations on operations which multiply enormous exponential numbers together, in different orders, to create key pairs. In order to reverse back through the ‘trapdoor’ a probably impossible number of guesses would have to be applied.

Latterly, elliptic curves such as the `secp256k1` curve used in Bitcoin have substantially simplified the computation problems. Rather than exponentials used by Diffie Helmann instead a repeated operation is applied to an elliptic curve function, and this itself creates a discrete log problem trapdoor in maths, far more efficiently. Figure 3.21 suggests how this works.

This makes it easier, faster, and cheaper to provide secure key pairs on basic computational resources. Elliptic curve solutions are not ‘provably’ secure in the same way as the Diffie-Hellman approach, and the security of this system is very sensitive to the randomness which is applied to the operation. Aficionados of Bitcoin use dice rolls or even more exotic means to add entropy (randomness) when creating keys. This really isn't necessary, the software does this well enough.

ECDSA has already been replaced by the more efficient Schnorr signature method [59] which uses the same mathematical curve so is

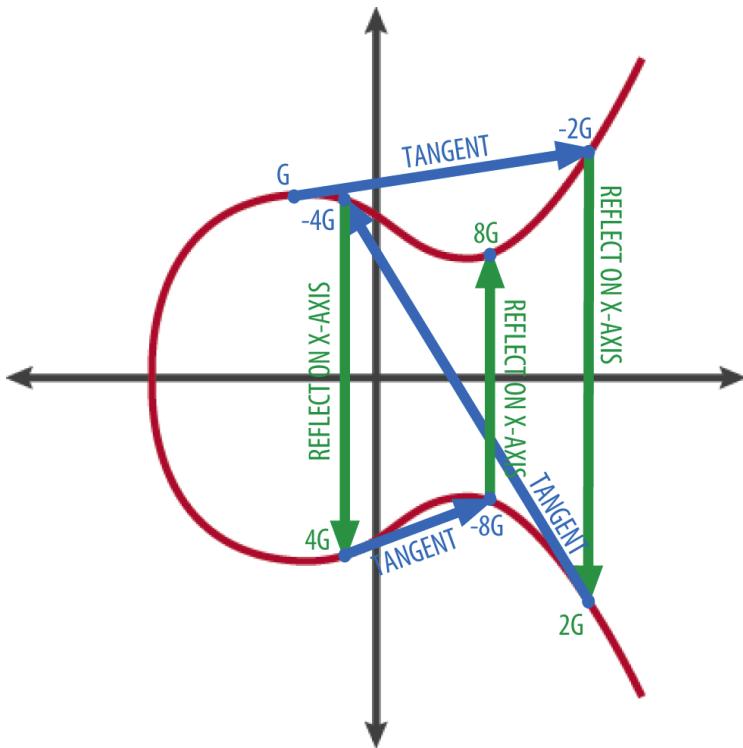


Figure 3.21: Given a start point on the curve and a number of reflection operations it's trivial to find a number at the end point, but impossible to find the number of hops from the two end points alone. (CC Mastering Bitcoin second edition)

backward compatible. This will take some time for organic adoption, and ECDSA will never be deprecated.

#### 3.4.3.2 Addresses & UTXOs

Ethereum has addresses which transactions flow in and out of. This is synonymous to a bank account number and so makes intuitive sense to users of banks. This is not the case in Bitcoin.

Bitcoin is a UTXO model blockchain. UTXO stands for unspent transaction output, and these are ‘portions’ of Bitcoin created and destroyed as value changes hands (through the action of cryptographic keys). They are the basis of the evolving ledger. This process is

described well by Rajarshi Maitra in this post.

*“Every Transaction input consists of a pointer and an unlocking key. The pointer points back to a previous transaction output. And the key is used to unlock the previous output it points to. Every time an output is successfully unlocked by an input, it is marked inside the blockchain database as ‘spent’. Thus you can think of a transaction as an abstract “action” that defines unlocking some previous outputs, and creating new outputs.”*

*These new outputs can again be referred by a new transaction input. A UTXO or ‘Unspent Transaction Output’ is simply all those outputs, which are yet to be unlocked by an input.*

*Once an output is unlocked, imagine they are removed from circulating supply and new outputs take their place. Thus the sum of the value of unlocked outputs will be always equal to the sum of values of newly created outputs (ignoring transaction fees for now) and the total circulating supply of bitcoins remains constant.”*

Fresh UTXOs are created as coinbase transactions, rewarded to miners who successfully mine a block. These can be spent to multiple output as normal. This is how the supply increases over time.

### 3.4.3.3 Bitcoin script

A Bitcoin script is a short chunk of code written into each transaction which gives conditions for the next UTXO transfer (spend). The limited scripting language and the features built into wallets on top, allow for some clever additional options beside receiving and spending. In fact, some of the more innovative features such as discrete log contracts (detailed later) are quite powerful, and can interact with the outside world. Scripts allow spends to be contingent on multiple sets of authorising keys, time locks into the future, or both.

### 3.4.3.4 Halving

As mentioned earlier, roughly every four year the ‘block reward’ given to miners halves. This gives the issuance schedule of Bitcoin; it’s monetary inflation. This ‘controlled supply’ feature was added to emulate the growth of physical asset stocks through mining. It’s exhaustively explained elsewhere and is somewhat immaterial to our transactional use case in metaverse applications.

### 3.4.3.5 Difficulty adjustment

The difficulty adjustment (also mentioned earlier) shifts the difficulty of the mining algorithm globally to re-target one new block every 10

minutes. This means that adding a glut of new mining equipment will increase the issuance of Bitcoins, in favour of the new mining entity, for up to 2 weeks, at which point the difficulty increases, the schedule resets, and the advantage to the new miner is diffused. Equally this protects the network against significant loss of global mining hashrate, as happened when China comprehensively banned mining. Again, this is explained in more detail elsewhere.

#### **3.4.3.6 Bitcoin nodes**

The Bitcoin network can be considered a triumvirate of economic actors, each with different incentives. These are:

- Holders and users of the tokens, including exchanges and market makers, who make money speculating, arbitraging, and providing liquidity into the network. Increasingly this is also real ‘money’ users of BTC, earning and spending in pools of circular economic activity. Perversely Bitcoin as a money is the fringe use case at this time.
- Miners, who profit from creation of new UTXOs, and receive payments for adding transactions to the chain. In return they secure the network by validating the other miners blocks according the rules enforced by the node operators.
- Node operators, who enforce the consensus rule-set, which the miners must abide by in order to propagate new transaction into the network. In return node operators optimise their trust minimisation, and help protect the network from changes which might undermine their speculation and use of the tokens [60].

There are currently around 15,000 Bitcoin nodes distributed across the world. Since IT engineer Stadicus released his Raspibolt guide in 2017 there has been an explosion of small scale Bitcoin and Lightning node operators. Around thirty thousand Raspberry Pi Lightning nodes (which are also by definition Bitcoin nodes) run one of a big selection of open source distributions. We will build toward our own throughout the book.

#### **3.4.3.7 Wallets, seeds, keys and BIP39**

In all the cryptographic systems described in this book everything is derived from a private key. This is an enormous number, and the input to the trapdoor function described earlier. As usual, it’s beyond the scope of this book to ‘rehash’ the detail. Prof Bill Buchanan OBE has a great post on the basic version of this process.

In modern wallets, private keys (and so too their public keys), and

addresses, are generated hierarchically. This is all part of BIP-0032. It starts with a single monstrously large number of up to 512 bits. From this are crafted Hierarchical Deterministic (HD) wallets, which use ‘derivation paths’ to make a tree of public/private key pairs, all seeded from this first number. This means that knowing the initial number, and the derivation path applied to it (just another number), wallets can search down the tree of derivations and find all the possible addresses. In this way a whole group of active addresses belonging to an entity can be held conveniently in one huge number (a concatenation of the input and path). This is the seed. Seeds are even more conveniently abstracted into a mnemonic called a seed phrase. Anyone interacting with these systems will see a 12 word (128 bits of entropy which is considered to be ‘enough’) or 24 word (256 bit) seed phrase. That phrase accesses the whole of the assets stored by that entity in the blockchain under it. A master key. These seeds can be generated by hand with dice, remember it’s just a huge number and the onward cryptography at play here.

An address in Bitcoin is derived from the public/private key pair. Again this is a one way hash function. The public/private keys can’t be found from the address. Addresses are really only a thing in wallets. They contain the element necessary to interact with the UTXOs. Many UTXOs can reside under an address, in that they just share the same keys. Wallets and nodes can monitor the blockchain to see transactions that ‘belong’ to addresses owned by the wallet, then they can perform unlocking of those funds to move them, through operations on the UTXOs via keys.

#### 3.4.3.8 Custody

The topic of ‘custody’ of Bitcoin (addresses,UTXOs) can be confusing at first. This is another area where there’s a lot of detail available, but not all of it is appropriate because increased complexity increases risk. Broadly though it’s important to remember that ownership of a UTXO is passed around using signing keys, which are functions of wallets. Wallets themselves don’t contain Bitcoin, they contain keys. The simplest approach is a software wallet. This is an application on a device, which stores the private keys, and manages signing of transactions which go onto the blockchain. It’s beyond the scope of this book to review or suggest software in detail, but Bluewallet on mobile devices, and Sparrow Wallet on desktop devices provide rich basic functionality if a reader wishes to get started immediately. Note that these software wallets send your extended public key (the path of



Figure 3.22: Seedsigner is an inexpensive open source project which scans the master seed in from a QR code to enable signing. One device can run a quorum based wallet (multisig).

those keys) to the wallet providers server, for the monitoring of the blockchain to happen on it's behalf. They're updated by the software vendor, not the blockchain direct. To get this to 'privacy best practice' commensurate with the aim of this book it's necessary to run a full node as detailed above, and connect the wallet software to that on a secure or local connection.

So called Hardware wallets like Coldcard should perhaps be termed signing devices. A reddit user simplifies this concept very well: *"Your hardware wallet is a safe that holds a key. Your bitcoin is in a mailbox that anyone can look at or put more bitcoin into, but nobody can take the bitcoin out unless they have the key stored in your safe. The 24 word seed phrase are the instructions needed to cut a new key."*. Rather than store Bitcoin they store the private key in a more secure way, in a device which interacts with a computer or phone, or else they scan in the seed each time themselves as is the case with opensource "seedsigner" (Figure 3.22).

For higher security it's possible to combine hardware and software wallets (signing devices) to provide a quorum of signatures required to move funds. More exotic still are proposals like "Fedimint" which allows groups such as families or villages to leverage their personal

trust to co-manage Bitcoin. What is not/rarely secure is leaving Bitcoin with a custodian such as an exchange as they simply issue you with an IOU and may abscond. In building toward a proposal for a product in this book it would be simple for us to build a metaverse which users simply paid to use. This is the norm up to now. Representative money would flow around in the metaverse and be changed back like game money at some point. This is not what we wish to promote, so everything will be a variation on “self-custody”, minimising third party trust for users.

### **3.4.4 Upgrade roadmap**

#### **3.4.4.1 Taproot**

‘Taproot’ is the most recent upgrade to the Bitcoin network. It was first described in 2018 on bitcoin-dev mailing list, and became BIP-0341 in 2019. It brings improved scripting, smart contract capability, privacy, and Schnorr signatures [59], which are a maximally efficient signature verification method. The network will always support older address types. It is rare to get such a large update to the network, and deployment and upgrade was carefully managed over several months under BIP-0008. Uptake will be slow as wallet manufacturers and exchanges add the feature. It can be considered an upgrade in progress (0.3%). Aaron van Wirdum, a journalist and educator in the space describes Taproot in detail in an article.

#### **3.4.4.2 AnyPrevOut**

BIP-0118, is a “soft-fork that allows a transaction to be signed without reference to any specific previous output”. It enables “Eltoo, a protocol that fulfils Satoshi’s vision for nSequence”

This is Lightning Network upgrade technology in the main. The Eltoo whitepaper or this more readable explanation from developer fiatjaf go into detail.

#### **3.4.4.3 CheckTemplateVerify**

BIP-0119 is “a simple proposal to power the next wave of Bitcoin adoption and applications. The underlying technology is carefully engineered to be simple to understand, easy to use, and safe to deploy”. At its most basic it is a constructed set of output hashes, creating a Bitcoin address, which if used, can only be spent under certain defined conditions. This is a feature called ‘covenants’. It enables a feature called ‘vaults’ which provides additional safety features for custodians.

There is currently some debate about the activation process, and the feeling is that it won't happen (soon).

#### **3.4.4.4 Blind merge mining**

BIP-0301 allows 'other' chains transactions to be mined into Bitcoin blocks, and for miners to take the fees for those different chains, without any additional work or thoughts by the miners. This is also a prerequisite for Drivechains (mentioned later), and improve Spacechains. In a way this can offer other chains the security model of the Bitcoin network, while increasing fees to miners, which might be increasingly important as the block subsidy falls. This is pretty fringe knowledge originally proposed by Satoshi, but has been refined since and is best explained by Paul Sztorc elsewhere. It is likely an important upgrade in light of the security budget of Bitcoin.

#### **3.4.4.5 Simplicity scripting language**

Simplicity is a proposed contract scripting language which is 'formally provable'. This would provide a radical upgrade to confidence in smart contract creation. It is work in progress, and looks to be incredibly difficult to develop in, despite the name. It is more akin to assembly language. Development has recently slowed, and the proposal requires a soft fork to Bitcoin. The main reason to think it stands a chance of completion vs other similar proposals is the powerful backing of Blockstream, one of the main drivers of the Bitcoin ecosystem, run by Adam Back (potential co-creator of Bitcoin).

#### **3.4.4.6 Tail emission**

It is conceivable though unlikely that Bitcoin will choose to remove the 21 million coin hard cap in the end. This would potentially result in a stable and predictable supply, compensating for lost coins, and reinvigorating the miner block reward. The Bitcoin narrative is **so** invested in the 'hard money' thesis that it seems such a hard fork would be contentious at least, and possibly existentially damaging. Peter Todd, long time Bitcoin Core contributor thinks the idea has merit and has described it in a blog post.

#### **3.4.4.7 Ossification**

The Bitcoin code is aiming toward so called "ossification". The complete cessation of development of the feature set. This would provide higher confidence in the protocol moving forward, as long term investors would be somewhat assured that the parameters of the tech-

nology would not change, and potentially pressure on the developers would reduce. There's a push to get some or all of the features described above in over the next few year before this happens. As ever this is a controversial topic within the development community. Notably Paul Sztorc, inventor of Drivechain feels strongly that cessation of innovation is a fundamental mistake, while also agreeing that ossification is necessary.

## 3.5 Extending the BTC ecosystem

The following section are by no means an exhaustive view of development on the Bitcoin network, but it does highlight some potentially useful ideas for supporting metaverse interactions in a useful timeframe.

### 3.5.1 Keet by holepunch

Tether and Bitfinex have released Keet messenger which allows peer to peer video calling and file sharing. It will be BTC and Tether enabled which allows transmission of value in a trust minimised fashion. Non custodial Lightning is coming to the product soon. It looks like an incredibly strong and interesting product suite is emerging here. If possible we would like to integrate this open source platform with our metaverse. It is built upon the same Hypercore “holepunch” technology used by Synonym.

### 3.5.2 Block & SpiralBTC

Block (formally the payment processor “Square” is now an umbrella company for several smaller ‘building block’ companies, all of which are major players in the space. Block itself is now part of the W3C web consortium, so they will be driving a new era of standards in distributed identity and value transfer.

SpiralBTC, formally ‘Square Crypto’ (a subsidiary of Square) is funding development in Bitcoin and Lightning. Their main internal product is the Lightning Development Kit (LDK). This promising open source library and API will allow developers to add lightning functionality to apps and wallets. It is a useful contender for our metaverse applications. They also fund external open source development.

### 3.5.3 BTCPayServer

BTCPayServer is one of the recipients of a Spiral grant. It is a self hosted Bitcoin and Lightning payment processor system which allows

merchants, online, and physical stores and businesses to integrate Bitcoin into their accounting systems. It might seem that if one were to use Bitcoin then a simple address published on a website might be enough, but this is far from privacy best practice. Using a single address creates a data point which allows external observers to tie all interactions with a given point of sale to all of the customers, and onward to all of their other transactions through the public ledger. Since we seek to employ cyber security best practice will avoid the issues with address reuse. Each Bitcoin address should be used just once. This is fine as there's essentially an unlimited number of addresses.

In a metaverse application there is no website to interact with, but fortunately BTCPayServer is completely open source and extensible, has a strong support community, and an API which could be integrated with a virtual world application. BTCPayServer supports the main three distributions of Lightning but would potentially need extending in order to work with newer technology like RGB or Omnibolt.

## 3.6 Lightning (Layer 2)

Lightning was a 2016 proposal by Poon and Dryja [61], and is a method for networks of channels of Bitcoin between parties, which can transfer value. The main public network is a community driven liquidity pool which enables scaling and speed improvements for the Bitcoin network. It makes Bitcoin more like money [62]. As with Bitcoin base chain there are multiple standards and approaches, but within Lightning these are not necessarily cross compatible with one another, resulting in several Lightning networks. This is to our advantage as innovation is possible within these smaller networks. It is mainly ‘powered’ by thousands of volunteers who invest in hardware and lock up their Bitcoin in their nodes, to facilitate peer-to-peer transactions. Zebka et al. found that although the network is “fairly decentralised” it is more recently skewing to larger more established nodes [63]. Though this is a grassroots technology the nature of the design means it can likely be trusted for small scale commercial applications.

The following text is from John Cantrell, an engineer who works on Lightning.

*“The Lightning Network is a p2p network of payment channels. A payment channel is a contract between two people where they commit funds using a single onchain tx. Once the funds are committed they can make an unlimited amount of instant & free payments over the channel. You can think of it as a tab where each person tracks how much money*

*they are owed. Each time a payment is made over the channel both parties update their record of how much money each person has. These updates all happen off-chain and only the parties involved know about them. When it's time to settle up the two parties can take the final balances of the channel and create a channel closing transaction that will be broadcast on chain. This closing transaction sends each party the final amounts they are owed. This means for the cost of two on-chain transactions (the opening and closing of the channel) two parties can transact an unlimited number of times and the overall cost of each transaction approaches zero with every additional transaction they make over the channel. Payment channels are a great solution for two parties to transact quickly and cheaply but what if we want to be able to send money to anyone in the world quickly and cheaply? This is where the Lightning Network comes into play, it's a p2p network of these payment channels. This means if Alice has a payment channel with Bob and Bob has a channel with Charlie that Alice can send a payment to Charlie with Bob's help. This idea can be extended such that you can route a payment over an arbitrary number of channels until you can reach the entire world. Routing a payment over multiple channels uses a specific contract called a Hash Time Locked Contract (HTLC). It introduces the ability for Bob and any other nodes you route through to charge a small fee. These fees are typically orders of magnitude smaller than onchain fees. This all sounds great but what if someone tries to cheat? I thought the whole point of Bitcoin was that we no longer had to trust anyone and it sure sounds like there must be some trust in our channel partners to use the Lightning Network? The contracts used in Lightning are built to prevent fraud while requiring no trust. There is a built-in penalty mechanism where if someone tries to cheat and is caught then they lose all of their money. This does mean you need to be monitoring the chain for fraud attempts."*

Lightning is a key scaling innovation in the bitcoin network at this time. It is seeing rapid development and adoption (Figure 3.23). The popular payment app "Cash App" integrates the technology allowing lightning interactions for their 40M users, and 'Lightning Strike' services the USA, El Salvador, large parts of Africa, and Argentina with zero exchange and transmission fees. It allows for unbound scaling of transactions (millions of transactions per second compared for instance to around 45,000 TPS in the VISA settlement network). Transaction costs are incredibly low, and the transaction speed virtually instantaneous.

The most popular lightning software is LND from Lightning Labs



Figure 3.23: Arcane research lightning adoption overview.

or C-Lightning from Blockstream. The software can be run on top of any Bitcoin full node, in a browser extension with a limited node, in a mobile app as a client or a server, or a hybrid such as the Greenlight server used by Breez wallet. Different trust implications flow from these choices.

### 3.6.1 Micropayments

Possibly the most important affordance of the Lightning network is the concept of micropayments, and streaming micropayments. It is very simple to transfer even one satoshi on Lightning, which is one hundred millionth of a bitcoin, and a small fraction of a penny. This can be a single payment, for a very small goods or service, or a recurring payment on any cadence. This enables streaming payments for any service, or for remittance, or remuneration. These use cases likely have enormous consequences which are just beginning to be explored. Integration of this capability into metaverse applications will be explored later.

### 3.6.2 BOLT12 and recurring payments

BOLT12 is a new and developing 'standard' which simplifies and extends the capability of the network for recurring payments, but can negotiate single payments too. The example keyring QR code seen in Figure 3.24 can be scanned to send single or recurring payments securely and anonymously to the holder.

### 3.6.3 Fedimint and Fedi app

From the [blog post](#) on the Fedi App website; Fedimint is:

- a form of community Bitcoin custody,
- utilising federations (a byzantine fault tolerant multi-sig wallet technology similar to Blockstream's Liquid network),
- run collectively by groups of trusted community members we call "guardians",
- for and on behalf of their communities,
- with privacy through Chaumian e-cash,
- and with close integration with the Lightning Network

Obi Nwosu sees Fedimint as the third vital pillar of the Bitcoin ecosystem. If Bitcoin is secure decentralised money, and Lightning is decentralised payments, then he says Fedimint is decentralised custody of the Bitcoin asset. The excitement in the community is such that this protocol is included in our metaverse stack later. With Fediment a clade of users within the metaverse would have near perfect transactional



Figure 3.24: A key fob with a Bolt12 QR code

privacy within their group inside the metaverse [9]. This could be a potentially huge group of users, and could include AI actors in the scene. Transactions with the outside world could be through lightning as already planned.

### 3.6.4 LNURL-auth

What is LNURL-auth? “*LNURL-auth is a generic authentication protocol. It authenticates the user using digital signatures, which means that the user needs to have a public-private key pair. Thanks to the rising popularity of lightning wallets, more and more users are in possession of and have easy access to such keys. Consequently, users are identified by their public keys, nothing else. The protocol does not require any other identifying information such as passwords, emails, usernames, or similar.*”

**LNURL-auth may be able to service all of our user management via LNBits.**

### 3.6.5 LNBits

LNBits is an open source, extensible, Lightning ‘source’ management suite. It is self hosted, and can connect to a variety of Lightning wallets, further abstracting the liquidity to provide additional functionality to

network users. Remember that all of these tools run without a third party, on a £200 setup, hosted at home or within a business. The best way to explore this is to describe *some* of the plugins.

- “Accounts System; Create multiple accounts/wallets. Run for yourself, friends/family, or the whole world!”
- Events plugin allows QR code tickets to be created for an event, and for payments to be taken for the tickets.
- Jukebox creates a Spotify based jukebox which can be deployed online or in physical locations.
- Livestream provides an interface for online live DJ sets to receive real-time Lightning tips, which can be split automatically in real-time with the music producer.
- TPoS, LNURLPoS & OfflineShop support online and offline point of sale (Figure 3.25).
- Paywall creates web access control for content.
- LightningTipBot is a custodial Lightning wallet and tip handling bot within the popular on Telegram instant messenger service.

Together these plugins are incredibly useful primitives which are likely to be translatable to a multi party metaverse application. A proposal for building a more specific plugin along these lines is detailed later.

**LnBits is capable of backing every object in a metaverse scene as an economic actor, with a key which is compatible with Nostr. This makes it the best choice and it will likely form the core of the proposed metaverse stack.**

## 3.7 Liquid federation (layer 2)

Liquid is an implementation on Blockstream Elements, and is itself part of the open source development contribution of Blockstream, the company started by Adam Back (of hashcash fame) and nearly a dozen other early cypherpunks and luminaries.

The Liquid side chain network, and it’s own attendant Lightning layer 2, is a fork of Bitcoin with different network parameters. In liquid the user of the network ‘pegs’ into the Bitcoin network, swapping tokens out from BTC to L-BTC (this can of course mean very small subunits of 1 Bitcoin). Once tokens have been ‘locked’ and swapped to Liquid the different network parameters used in the fork allow a different trust/performance trade-off. Liquid is fast on the L1 chain, cheaper to use at this time, and more private. The consensus achieved on this side chain network is faster because it is a far smaller group of node operators. The next block to be written to the side chain is chosen



Figure 3.25: Two of the many prebuilt and kit options for Lightning ‘point of sale’

by a node operated by a member of a federation of dozens of major contributors to the Bitcoin technology space. These ‘trusted’ nodes all check one another’s security and network operations, meaning that the network is as secure as the aggregate of the trust placed in half of the membership at any one time. There are still dozens of major companies, development teams, and individual actors, with significant reputational investment.

“Federation members contribute to the Liquid Network’s security, gain voting rights in the board election and membership process, and provide valuable input on the development of new features. Members also benefit from the ability to perform a peg-out without a third party, allowing their users to convert between L-BTC and BTC seamlessly within their platform.”

Crucially for our purposes here Liquid allows tokenised asset transfer. Anyone can issue an asset on Liquid. Such transfers of assets may be orders of magnitude cheaper than on chain Bitcoin transactions, but still potentially orders of magnitude more expensive than a simple Lightning transaction of value on the Bitcoin network.

Blockstream plan to add arbitrary (user generated) token support to their ‘Core Lightning’ implementation at some point. This would be a very strong choice for specific use cases within an economically enabled metaverse application. When participants wish to ‘cash out’ of the Liquid network they must do this through one of the federation members who activate the other side of the ‘two-way peg’, dispensing the equivalent amount of Bitcoin. This is transparently handled through Blockstream’s “green wallet”.

All of this has the advantage of a far lower energy footprint compared to the main chain, but it’s not quite ready with a full suite of affordances.

The Liquid network is being used as the underlying asset for a novel new global financial product. El Salvador are working with Blockstream to issue a nation state backed bond.

## 3.8 Bitcoin Layer 3

Increasingly important features of modern blockchain implementations are programmability through smart contracts, and issuance of arbitrary tokens. Assigning a transaction to represent another thing like an economic unit, energy unit, or real world object, and operating on those abstractions within the chain logic. Chief among these use cases are stablecoins such as Tether, which are pegged to national currencies

and described in the next section. Bitcoin has always supported very limited contracts called scripts, and stablecoin issuance has existed in Bitcoin since Omni Layer. Omni was the first issuer of Tether, but more recently these important features have passed to other layer one chains. This year is likely to see the resurgence of this capability on Bitcoin, which of course benefits from a better security model. Once again, there is a strong assertion by some that this isn't even possible. The debate is complex and unresolved.

In order to properly understand the use of Bitcoin based technologies in metaverse applications it is necessary to examine what these newer 'layer 3' ideas might bring.

### **3.8.1 LNP/BP and RGB**

LNP/BP is a non profit standards organisation in Switzerland which contributes to open source development of Bitcoin layer 3 solutions into the Lightning protocol, and Bitcoin protocol (LNP/BP). One of the core product developments within their work is the 'RGB' protocol, which is somewhat of a meaningless name, evolved from "coloured coins" which were an early tokenised asset system on the Bitcoin network. RGB represents red, green, and blue. The proposal is built upon research by Todd and Zucco. RGB is regarded as arcane Bitcoin technology, even within the already rarefied Bitcoin developer communities. Zucco provides the following explanation:

*"When I want to send you a bitcoin, I will sign the transaction, I will give the transaction only to you, you will be the only one verifying, and then we'll take a commitment to this transaction and that I will give only the commitment to miners. Miners will basically build a blockchain of commitments, but without the actual validation part. That will be only left to you. And when you want to send the assets to somebody else, you will pass your signature, plus my signature, plus the previous signature, and so on."*

This is non-intuitive explanation of Todds 'single-use-seals', applied to Bitcoin, with the purpose of underpinning arbitrary asset transfer secured by the Bitcoin network. In this model the transacting parties are the exclusive holders of the information about what the object they are transferring actually represents. This primitive can (and has) been expanded by the LNP/BP group into a concept called 'client side validation'. It's appropriate to explain this concept several times from different perspectives, because this is potentially a profoundly useful technology for metaverse applications.

- A promise is made to spend a multi output transaction in the fu-

ture. This establishes the RGB relationships between the parties.

- One of the pubkeys to be spent to is known by both parties.
- The second output is unknown and is a combination of the hash of the state, and schema, from the operation which has been performed.
- When the UTXO is spent the second spends pubkey can be processed against the shared data blob to validate the shared state in a two party consensus (sort this out, it's nonsense).
- This is now tethered to the main chain. Some tokens from the issuance have gone to the recipient, and the remainder have gone back to the issuer. More tokens can be issued in the same way from this pool.
- A token schema in the blob will show the agreed issuance and the history back to the genesis for the token holder.
- The data blob contains the schema which is the key to RGB functions and the bulk of the work and innovation.
- Each issuance must be verified on chain by the receiving party.

This leverages the single-use-seal concept to add in smart contracts, and more advanced concepts to Bitcoin. Crucially, this is not conceptually the same as the highly expressive ‘layer one’ chains which offer this functionality within their chain logic. In those systems there is a globally available shared consensus of ‘state’. In the LNP/BP technologies the state data is owned, controlled, and stored by the transacting parties. Bitcoin provides the cryptographic external proof of a state change in the event of a proof being required. This is an elegant solution in that it takes up virtually no space on the blockchain, is private by design, and is extensible to layer 2 protocols like Lightning.

This expanding ecosystem of client side verified proposals is as follows:

- RGB smart contracts
- RGB assets are fungible tokens on Bitcoin L1 and L2, and non fungible Bitcoin L1 (and somewhat on L2).
- Bifrost is an [extension](#) to the Lightning protocol, with it’s own Rust based node implementation, and backwards compatibility with other nodes in the network. This means it can transparently participate in normal Lightning routing behaviour with other peers. Crucially however it can also negotiate passing the additional data for token transfer between two or more contiguous Bifrost enabled parties. This can be considered an additional network liquidity problem on top of Lightning, and is the essence of the “Layer 3” moniker associated with LNP/BP. It will re-

quire a great number of such nodes to successfully launch token transfer on Lightning. As a byproduct of it's more ‘protocol’ minded design decisions Bifrost can also act as a generic peer-to-peer data network, enabling features like Storm file storage and Prometheus.

- AluVM is a RISC based virtual machine (programmable strictly in assembly) which can execute Turing complete complex logic, but only outputs a boolean result which is compliant with the rest of the client side validation system. In this way a true or false can be returned into Bitcoin based logic, but be arbitrarily complex within the execution by the contract parties.
- Contractum is the proposed smart contract language which will compile the RGB20 contracts within AluVM (or other client side VMs) to provide accessible layer 3 smart contracts on Bitcoin. It is a very early proposal at this stage.
- Internet2: “Tor/noise-protocol Internet apps based on Lightning secure messaging
- Storm is a lightly specified escrow-based bitcoin data storage layer compliant with Lightning through Bifrost.
- Prometheus is a lightly specified multiparty high-load computing framework.

Really, any compute problem can be considered applicable to client side validation. In simplest terms a conventional computational problem is solved, and the cryptographically verifiable proof of this action, is made available to the stakeholders, on the Bitcoin ledger.

Less prosaically, at this stage of the project the more imminent proposed affordances of LNP/BP are described in ‘schema’ on the project github. The most interesting to the technically minded layperson are:

- RGB20 fungible assets. This could be stablecoins like dollar or pounds representation. This is a huge application area for Bitcoin, and similar to Omni, which will also be covered next.
- RGB21 for nonfungible tokens and ownership rights. In principle BiFrost allows these to be transferred over a the Lightning network, significantly lowering the barrier to entry for this whole technology. DIBA have this technology working on testnet.
- RGB22 may provide a route to identity proofs. This is covered in detail later.

Federico Tenga is CEO of ‘Chainside’ and an educator and consultant in the space. He has written an up-to-date “primer”, which is still extremely complex for the uninitiated, but does capture how the RGB

token transfer system works. That medium article also touches on Taro, which is next.

### 3.8.2 Taro

Taro is an very new initiative by Lightning Labs to allow assets to transmit on the Lightning network. It is more similar to RGB above than Omnibolt below. They say: *“Taro enables bitcoin to serve as a protocol of value by allowing app developers to integrate assets alongside BTC in apps both on-chain and over Lightning. This expands the reach of Lightning Network as a whole, bringing more users to the network who will drive more volume and liquidity in bitcoin, and allowing people to easily transfer fiat for bitcoin in their apps. More network volume means more routing fees for node operators, who will see the benefits of a multi-asset Lightning Network without needing to support any additional assets.”*

The project has clearly been under development by the lead developer at Lightning Labs for some years and seems both capable and mature, though they are obviously following the model of ‘co-opting’ open source ideas (from RGB) to garner venture capital funding. They credit RGB in the github. More will doubtless be added to this section and it seems a contender for our metaverse purposes, being less broadly ambitious than RGB upon which it’s based, but perhaps more focused and implemented. The key feature of Taro seems to be that only the first and last hop in a multi-hop lightning transaction need to support Taro, because of external data validation databases called “universes”. This is an advance on the RGB proposal. The technical specs are now on the lightning labs web pages, and code has been released.

### 3.8.3 Spacechains

Spacechains is a proposal by Ruben Somsen. It is a way to provide the functionality of any conceivable blockchain, by making it a sidechain to Bitcoin.

Like RGB described earlier it’s a single use seal, but which can be closed by the highest bidder.

In a spacechain the Bitcoin tokens are destroyed in order to provably create the new spacechains tokens at a 1:1 value. These new tokens only have worth moving forward within the new chain ecosystem they represent, as they cannot be changed back. They nonetheless have the same security guarantees as the bticonf main chain, though with a radically reduced ecological footprint (x1000?), and higher performance.

Each ‘block’ in the new chain is a single bitcoin transaction. The high level features are:

- Outsource mining to BTC with only a single tx per block on the main chain.
- One way peg, Bitcoin is burnt to create spacechain tokens.
- Allows permissionless chain creation, without a speculative asset.
- Fee bidding BMM is space efficient and incentive compatible. Miners just take the highest fees as normal.
- Paul Sztorc raised the idea
- It’s best with a soft fork but possible without

The concept is explained fully in a recent presentation at Advancing Bitcoin conference.

### **3.8.4 Statechains, drivechain, softchains**

There are many proposals for layer 2 scaling solutions for the bitcoin network. Ruben Somsen describes Softchains, Stateschains, and Spacechains, while Drivechain is described by the author Paul Sztorc on the project web pages and is split across BIP-0300 for drivechain and BIP-0301 for a “blind merge mining”, a soft fork which it’s unlikely to get. They are all hypothetical with the exception of sidechains.

## **3.9 Risks and mitigations**

Looking across the whole sector, this paragraph from the Bank of International Settlement (BIS) sums everything up:

*“...it is now becoming clear that crypto and DeFi have deeper structural limitations that prevent them from achieving the levels of efficiency, stability or integrity required for an adequate monetary system. In particular, the crypto universe lacks a nominal anchor, which it tries to import, imperfectly, through stablecoins. It is also prone to fragmentation, and its applications cannot scale without compromising security, as shown by their congestion and exorbitant fees. Activity in this parallel system is, instead, sustained by the influx of speculative coin holders. Finally, there are serious concerns about the role of unregulated intermediaries in the system. As they are deep-seated, these structural shortcomings are unlikely to be amenable to technical fixes alone. This is because they reflect the inherent limitations of a decentralised system built on permissionless blockchains.”*

This might seem like reason enough to stop here and wait for proper digital currency (expanded later), but Bitcoin is here now, is likely unstoppable in, and with mitigations in place might have uses

if developed properly. Perhaps surprising the same BIS is allowing up to 2% of bank reserves to be held in crypto assets, including Bitcoin, according to their June 2022 Basel Committee on Banking Supervision report.

Lightning is still considered to be experimental and not completely battle tested. There have been various attacks and a major double spend attack may be possible [64], but there have been no major problems in the years it's been running with careful design choices and cybersecurity best practice it is likely a production ready component of our planning.

### 3.9.1 Sociopaths everywhere

In the wake of the rampant crime spree by Sam Bankman-Freid and his top teams at Alameda research and the Bahamas registered exchange ‘FTX’ the whole industry has suffered, and will continue to suffer, seismic shocks. There is a chance the sector will never recover, and that we have already seen the top of the hype bubble. Fortunately this doesn't diminish our use cases for these technologies, as we were never planning to speculate with the asset, but rather use the network.

### 3.9.2 Digital assets

For digital assets more generally it is useful to look at the recent “whole government executive order” signed by President Biden early in 2022. It was mainly framed in terms of “responsible innovation, and leadership” in the new space. The resulting, “Comprehensive Framework for Responsible Development of Digital Assets” is a product of multi agency collaboration and can be seen as 9 reports and a summary document, and has been long anticipated. The summary itself is neither particularly comprehensive nor a framework, and mainly serves to identifies high level risks, aspirations, and challenges, and strongly hints toward eventual development of a “digital dollar” (CBDC, expanded later).

The risks section of the original executive order shows how legislators are framing this, so it's useful to break down here.

- Consumer and business protections. This is likely to pertain to custodians and is much needed. Misselling is rife. Security presents a challenge.
- Systemic risk, and market integrity are a concern. The legislators clearly worry about contagion risks from the sector.
- Illicit finance (criminality and sanction busting etc) are a concern, but not particularly front and centre[65]. Criminality in 2021

was a mere 0.15% of transactions according to Chainalysis, but this number varies year to year. There are claims that Iran have begun official overseas buying with cryptocurrencies, but again, the numbers are small. One of the better sections of the work is the US treasury department's recently published 'National Risk Assessments for Money Laundering, Terrorist Financing, and Proliferation Financing'. This is a comprehensive report and speaks to careful research across the space. It is broken into three parts. Perhaps surprisingly, while they do see activity in these areas, they do not rate the risk as very significant. Cash remains the main problem for illicit funding. There is some talk that the nature of public blockchain analysis allows greater oversight of these tools and that this is to the advantage of government and civil enforcement agencies.

- Highlighting the need for international coordination suggests they are mindful of jurisdictional arbitrage. The partial regulatory capture of these technologies, where activity flows to globally more lenient legislative regimes, continues to be a concern. Many of the centralised exchanges for instance are located in tax havens such as Malta. As the world catches up with these products it is likely that this will be smoothed out.
- Climate goals, diversity, equality and inclusion are mentioned. It seems that the "environment" aspect of ESG is more important than "social" and "governance" at this time.
- Privacy and human rights are mentioned.
- Energy policy is highlighted, including grid management and reliability, energy efficiency incentives and standards, and sources of energy supply.

The latest summary report resulting from the above guidance actually adds little tangible meat to the bones. This possibly reflects the complexity of these issues. The recommendations seem to be broadly as follows, and are really a copy/paste of the executive order.

- Carry on doing research into central bank digital currencies, but there's no particular rush.
- Support development of better instant payment methods both at home and globally.
- Ensure consumer and systemic protections.
- More monitoring, civil and criminal prosecutions.
- Issue more rules and clarity in response to risks (this is actually likely net positive as rules are currently unclear).
- Improve global reporting on users (KYC/AML).

The government rhetoric to date in the USA can be seen to be converging on an understanding of the technology, at different rates in different parts of government. One thing that seems to shine through is their own perception of their global leadership on legislation on these matters. They seem to assume that what they decide will guide the world, and this may be true through their KYC/AML pressures.

A recent proposed bi-partisan bill in the USA will likely help inform global law, though it is unlikely to pass itself. It encourages the use of Bitcoin as a medium of exchange by applying a tax exemption on transactions of less than \$200. The issue of whether an asset is a commodity (a raw material thing) or a security (a promise) is left to a couple of major government agencies to unpick, with corresponding reporting requirements. Crucially for this book these nascent bills all regard both Bitcoin and Ethereum as sufficiently decentralised to qualify as commodities, meaning they would enjoy more lenient oversight. Far more likely to pass is the proposed DCCPA bill which has senior lawmaker support and would see commodities in the space regulated in such a way that trading of it could be halted in the USA. In this line of policy, exchanges will be required to do far more reporting, and would be penalised for trading against their customers. DOAs and DeFi are the big potential losers. In a maddening twist the Office of Government Ethics in the USA has banned anyone who owns digital assets from working on the legislation. This is an exceptional move and likely to result in poorly crafted laws in the first instance.

The most recent and troubling example is the US ban on any Ethereum assets which have been through a “mixer service” that obfuscates history. This is a huge constraint on the code and smart contract itself, not just sanctions against individuals. It has ‘free speech’ and constitutional implications [66]. More such actions and arrests of developers are feared. It has led to Circle (who issue the USDC stablecoin) blacklisting every address sanctioned by the US government. Centrally issued digital assets are obviously neither uncensorable nor permissionless. This intersects (again) with the whole question of what decentralisation means and how effective it can be in its stated goal of circumventing global policies.

### 3.9.3 Bitcoin specifically

In addition it's useful for this document to focus more on the technical challenges to the Bitcoin network.

- The block reward is reduced every 4 years (epochs). This means a portion of the mining reward is trending to zero, and nobody

knows what effect this will have on the incentives for securing the network through proof of work [67]. It is increasingly being discussed as the major eventual problem for the network.

- Stablecoins are a vital transitional technology (described later) but do not meaningfully exist yet on the Bitcoin network. This may change.
- Bitcoin lacks privacy by design. All transactions are publicly viewable. This is a major drag to the concept of BTC as a money. Upgrade of the network is possible, and has indeed been achieved for a Bitcoin fork called Litecoin [68].
- The Lightning network (described later) has terrible UX design at this time.
- The basic ‘usability’ of the network is still poor in the main. Any problems which users experience demand a steep learning curve and risk loss of funds. There is obviously no technical support number people can call.
- Only around one billion unspent transactions can be generated a year on the network. This means that it might become impossible for everyone on the planet to have their own Bitcoin address (with its associated underpinning UTXO).
- Chip manufacture is concentrated in only a few companies and countries, as identified by Matthew Pines.
- Potential constraints on monetary policy flexibility.
- Future protocol changes.
- Unanticipated effects on the domestic and international energy system.
- Vulnerability to adversary attacks are widely studied[69, 70, 71], and still pretty much completely speculative because of the complex nature of the attack surface.
- Mining tends toward economy of scale concentration. Many are already on their own specialised network to connect to one another.
- Future hard forks. There will doubtless be pressure to fork the code to add inflation, or ESG mitigations, or to fix the UNIX clock issue in 2106. Each fork is a risk.
- Other unknown, unanticipated risks given Bitcoin’s limited 13-year history.



## 4. Money in the real world

It is necessary here to briefly examine what money actually is in the world outside of metaverses, so we can understand it in the context of a virtual global space. In the previous section Bitcoin can be viewed in a couple of different lights. As a self custody digital bearer asset it can be viewed as ‘property’, like gold, i.e. not a liability on someone else’s asset sheet. Indeed this has long been one of the assertions of the community and it finds favour in law, possibly most ironically in China which of course banned mining. ‘Money’ though is a far more slippery concept to grasp. It seems very likely that Bitcoin is evolving as a “base money”, and it’s important to define that, but there are many other kinds of money within the online world which can potentially transfer value within virtual social spaces.

### 4.1 Defining money

Money is an economic good, that is generally accepted as a medium of exchange. This simple and specific description doesn’t do justice to the complexity of everything that humans consider to be money. Even the Encyclopaedia Britannica strays from this immediately in their definition:

*“money, a commodity accepted by general consent as a medium of economic exchange. It is the medium in which prices and values*

*are expressed; as currency, it circulates anonymously from person to person and country to country, thus facilitating trade, and it is the principal measure of wealth.”.*

In which it can be seen that the principle measure of wealth might not be money at all, but rather property, credit, etc. So are these things money? Is a promise on a ledger money? The assertion at the top of this section is challenged by different schools of economic thinking. Global debt is around an order of magnitude larger than base money, and most wealth is stored in illiquid land/built environment (some \$300T), and yet the system seems to work fine. The debt theory of money offered by anthropologist David Graeber suggests that money is an abstraction of barter, and thereby ‘credit’, but credit clearly pre-dates money, and needs no barter, commodity, intermediary nor underlying asset [72]. This suggests that money is something slightly different.

Money seems to have evolved for two principle purposes; trade outside of a village context, and inheritance [73]. In doing this it somewhat replaced and augmenting ‘credit’, which as said above, was a promise between parties based on future actions, and likely as old as rudimentary language itself.

Money can be divided into two categories, which are fungible (interchangeable) from the point of view of the users. Base money is ‘commodity’ money which is backed by assets, or tangible physical (or digital) goods through the actions of a central bank ledger, and is around \$30-\$40T. Everything else is ‘fiduciary media’ [74].

All fiduciary money is credit but not all credit is fiduciary money. Nobody knows the extent of the global supply of fiduciary media. It encapsulates all the new digital money platforms like PayPal, gift cards, offshore accounts and all manner of other vehicles, and is thought to be many tens of trillions of pounds[75]. This somewhat muddies the waters since money that is backed by ‘something’ blends away into money which cannot reasonably be assayed. This in turn undermines the assertion that money is backed. It seems that a combination of available raw materials and labour, central banks and their associated political structures [76], and global markets drive the value of money up and down relative to “stuff” in the shops. This manifests as ‘inflation’, which is ‘possibly’ the effect of not pegging money to an asset such as silver, or gold as in the past [77]. While the gross drivers of inflation seems to be accepted and understood, nobody seems very sure how the various aspects interact. It may be that central banks actually have no decent response to global monetary pressures and are overdue a paradigm shift, as explained by Daniela Gabor (Professor of economics

and macrofinance at UWE Bristol):

*“...last stage of a central banking paradigm, when it implodes under the contradictions of its class politics? Under the financial capitalism supercycle of the past decades, inflation-targeting central banks have been outposts of (financial) capital in the state, guardians of a distributional status-quo that destroyed workers’ collective power while building safety nets for shadow banking.*

*The limits of this institutional arrangement that concentrates (pricing) power and profit in (a few) corporate hands are now plain to see. If the climate and geopolitical of 2022 are omens of Isabel Schnabel’s Great Volatility that most central banks and pundits expect for the near future, then macro-financial stability requires new framework for co-ordination between central banks and Treasuries that can support a state more willing to, and capable of, disciplining capital.*

*But such a framework would threaten the privileged position that central banks have had in the macro-financial architecture and in our macroeconomic models. The history of central banking teaches us that policy paradigms die when they cannot offer a useful framework for stabilising macroeconomic conditions, but never at the hands of central bankers themselves.”*

All this makes it hard to find a universally accepted and explicable definition of money. The best approach may be to look at the properties of a thing which is asserted to be a money. In his book ‘A history of money’, Glyn Davies identifies “cognisability, utility, portability, divisibility, indestructibility, stability of value, and homogeneity” [78].

Stroukal examines Bitcoins’ likely value as a money from an Austrian economics perspective and identifies “portability, storability, divisibility, recognizability, homogeneity and scarcity” [79].

A helpfully brief and useful web page by Desjardins from 2015 describes some properties and explains them in layman’s terms below:

- Divisible: Can be divided into smaller units of value.
- Fungible: One unit is viewed as interchangeable with another.
- Portable: Individuals can carry money with them and transfer it to others.
- Durable: An item must be able to withstand being used repeatedly.
- Acceptable: Everyone must be able to use the money for transactions.
- Uniform: All versions of the same denomination must have the same purchasing power.
- Limited in Supply: The supply of money in circulation ensures

values remain relatively constant.

#### 4.1.1 Global currency interactions

The legacy moniker “third world” came from a division of the world along economic lines [80]. At the time this was the petrodollar / neo-institutional hegemony [81, 82], vs the economic superpower of the soviet block, and then ‘the rest’; unaligned economic powers.

This old framework has fallen away with the associated terminology, but it’s useful to look at what money ‘is’ from a global viewpoint, because all money is effectively trust in the liability held by some defined counter party.

Right now the dollar system is still predominant, but it seems likely that there are new axes forming, especially around the Chinese Yuan. It’s clear that central banks have been aware of this potential transition away from a global dollar / energy system. The Dollar has potentially suffered from the radical expansion of the money supply over the last 70 years or so under the private “Eurodollar” system [83]. Macro markets commentator Peccatiello describes this as follows: *“Our monetary and credit system is USD-centric: the lion share of international debt, trade invoices, asset classes and FX volume is settled or denominated in US Dollars. Funnily enough though, direct access to \$ liquidity is only available to entities located in the United States but in a credit-based system the rest of the world also has an incentive to leverage in US Dollars to boost or enhance their global business models. That means European banks, Brazilian corporates or Japanese insurance companies which want to do global business will most likely get exposure to \$-denominated assets and liabilities (\$ debt) despite being domiciled outside the United States.”*

Some policy makers have been looking back to the great economist John Maynard Keynes’ ideas for a neutral basket of assets as a global synthetic hegemonic currency [84, 85] which would almost certainly consist partly of gold [86].

Use of the dollar system has recently been shown more and more to be contingent on adherence to US defined political principles. This is evidenced most starkly by the seizure of Russian central bank foreign reserves, a new and untried projection of monetary power.

The Chinese Yuan/Renminbi is potentially stepping in where the petrodollar is now waning [87]. The effects of this expansion of economic influence by China, through a potential petro-Yuan, and the belt and road initiative [88], are not yet felt, but the lines are fairly clearly defined and may be felt over the coming decades. The Euro system is

potentially even less stable because of recent energy supply pressures, and internal tensions in the bond markets. Though it seems to be less ‘weaponised’ [89], it comes with its own restrictions for use, especially through the International Monetary Fund (IMF). To give context to this it is useful to paraphrase Whittemore’s podcast which gave a high level view of Gladsteins critique of the IMF: “*The terms of the most recent IMF loans to Argentina; one that was just finalized this year was that the country’s leadership had to try, as part of their agreement, to discourage citizens from engaging in the use of cryptocurrencies. The most recent deal was a 45 billion dollar deal which is a restructuring of that 57 billion program that Alex mentioned. The provision in question was called ‘strengthening Financial resilience’, and says ‘to further Safeguard Financial stability we are taking important to discourage the use of cryptocurrencies with a view to preventing money laundering informality and disintermediation’. They explicitly do not want citizens of that country to disintermediate. They want them to have to go through the system that the IMF is “restructuring”, meanwhile inflation this year is around 72 percent. Last year it was 48 the year before 42 the year before that 53 percent clearly something is not working. It’s not surprising to me then that Argentina is an absolute hotbed for people who are involved in Bitcoin’*

The new ‘third world’ who are excluded from the Dollar and/or Yuan poles of the global economy might drift toward the ‘basket of assets’ discussed by Keynes and Carney above. As mentioned this will certainly have a component of gold, and likely other commodity assets such as rare metals. This is described at length by Hudson[89]. For our purposes here it’s also possible that there would be a small ‘hedge’ allocation of Bitcoin or even a global axis of ‘unaligned’ nations using the asset [90, 91]. Block and Wakefield research found that in developed nations Bitcoin is treated as an investment, while in less wealthy demographics there is interest in the utility. This is evidenced in the early nation state adoption seen and described to date, and the game theory incentive explained by Fidelity in the introduction. It’s too early to tell if this ‘unaligned money’ could constitute a global economic pole, but it’s interesting that some commentators are now even discussing this, and that carbon neutrality research is being undertaken specifically for this application.

## 4.2 International money transfer networks

Transferring money from one financial jurisdiction to another is itself a global marketplace which has accreted over the entire course of human history. It's far less useful here to discuss the mythos of salt and seashells as a mechanisms of international remittance and taxation [92, 93]. Suffice it to say that there are dozens, if not hundreds, of cross border payment companies who make their business from taking a percentage cut of an international money transfer. There are also hundreds if not thousands of banks who offer this service as part of their core business portfolio. This section looks at some of the major players, and their mechanism, to contextualise the more recent shifts brought about by technology.

### 4.2.1 Swift, ISO 20022, and correspondence banking

Society for Worldwide Interbank Financial Communiactions (SWIFT) was initially formed in 1973 between 239 banks across 15 countries. They needed a way to improve handling of cross border payments. It is now the global standard for financial message exchange in over 200 countries, and has recently found itself under a fresh spotlight, during the invasion of Ukraine. The system handles around 40 million short, secure, code transmissions a day, which represent crucial data about a transaction and the parties involved. It is used by both banks and major financial institutions to speed up settlement between themselves, on behalf of the clients and customers. It replaced the Telex (wire transfer) system. The new proposed and incoming standard to replace SWIFT is ISO20022 which is a complex and data rich arrangement. To be clear the SWIFT consortium are promoting this new standard to their 11,000 plus global user base, and there is significant investment and hype from major financial players, but it seems unclear what the actual take-up will or even should be. A group of 'cryptocurrencies' are heavily involved in the ISO20022 standard, and there's been experimentation with private permissioned distributed ledger technologies. It's actually somewhat unclear what value they bring, and possible that the relationship of these public ledgers to international bank to bank messaging is a marketing distraction. Note that SWIFT, ISO20022, and the associated tokens within crypto are all themselves products which have a business model. They are all intermediaries which will demand a mediating fee somewhere. All of this proposed functionality could be replaced by central bank digital currencies, which will be discussed later in the section.

## 4.2.2 VISA and Mastercard

Both major credit card companies are building out their “crypto” capabilities. Mastercard have launched a back end platform to mitigate fraud when buying digital products with their cards. VISA have announced a “crypto business to business support unit”. They have also published a white paper to allow users to improve their experience.

## 4.2.3 Money transfer operators

International Money Transfer Operators analysis

western union etc, moneygram, transferwise,

## 4.2.4 Digital disruptive fintech

It seems that the neobank providers of digital banking apps are likely to converge with native digital asset “wallets”. This is also the thesis advanced by the Ark investments Big Ideas paper.

CNN have a useful primer of the most prevalent mobile digital payment methods. This can be seen in Figure 4.1. This comparison makes it pretty clear that Bitcoin is not ready as a personal mobile payment system. That’s not to say that there isn’t a place for the underlying technology in global payment processing. The most interesting example of this is Strike, a product in the international fintech arena. It is a ‘global’ money transmitter which uses bank connections in local currencies, but a private version of the Lightning network with settlement on the Bitcoin main chain. In practice users connect the app to their bank and can send money to the bank connected Strike app of another user instantly, and without a fee. This is a far better product than those previously available. In principle it’s open API allows many more applications to be integrated into the Strike back end. Twitter already uses this for international tipping (and remittance). It seems that this is a perfect contender for supporting transactions in open metaverse applications, and that may be true, but Strike is currently only available in three countries (USA, El Salvador, Argentina).

Paypal, xoom, Strike, servicing smaller payments, cashapp, venmo, revolut, Paypal especially is noteworthy for their recent Orwellian gaffe suggesting in their terms and conditions that they would be able to fine users \$2500 for “disseminating informational”. They quickly walked this back but this kind of private fintech action is highly suggestive of a need for uncensorable money such as Bitcoin.

				
Apple Pay	Samsung Pay	Google Wallet	PayPal	Bitcoin
<b>AVAILABILITY</b>				
Only iPhone 6.	Only Samsung Galaxy S6.	Any device with the app.	Any device with the app.	Any device with the app.
<b>HOW YOU USE IT</b>				
				
Fingerprint OK for tap-to-pay (at new registers) and online purchases.	Fingerprint OK for tap-to-pay (at new registers)	Tap-to-pay (at new registers, only on NFC-enabled Android phones). Send money via app or email.	Send money via email or phone number.	Scan QR code
<b>HOW IT WORKS</b>				
Uses NFC (radiowaves) to send your encrypted payment information.	Uses NFC. At old credit card machines, uses MST (magnetic fields).	Like a debit card. You recharge it. At new registers, uses NFC.	Uses PayPal network to transmit credit card or debit transactions.	Totally independent money system.
<b>SECURITY</b>				
				
Most secure. Retailers don't even get your credit card.	Most secure. Retailers don't even get your credit card.	Secure. Retailers don't get your credit card, but Google does.	Secure. Retailers don't get your credit card, but PayPal does.	Tricky. Secure, but you're on your own. Lose a password? Get hacked? Your money is gone.
<b>PROS</b>				
Quick and easy.	Quick and easy. Works everywhere.	Easy. Great for sending money to friends.	Easy. Great for sending money to friends.	Very private. Easy. Great for sending money to friends.
<b>CONS</b>				
Doesn't work everywhere. Only some places have NFC-enabled registers.	Magnetic option is annoying. You must hold it a certain way above the magnetic stripe reader.	Doesn't work everywhere. Only some places have NFC-enabled registers.	Only works at merchants who accept PayPal. It's a bit rare in person.	Difficult to obtain bitcoins. Rarely ever accepted. Few merchants use this.

Infographic: Gwen Sung / CNNMoney

Jose Pagliery

Figure 4.1: Comparison of mobile based payment systems

## 4.2.5 Stablecoins

Stablecoins are ‘crypto like’ instruments which are ‘pegged’ at a 1:1 ratio with nationally issued Fiat currencies. In fact they usually correspond to units of privately issued debt underwritten by a variety of different assets. This is (depending on the issuing company’s model) a far more risky unit of money than the nominal currency that they represent, but they offer significant utility. They allow the user to self custody the cryptographic bearer instrument representing the money themselves, as with blockchain. This may afford the user less friction in that they can transmit the instrument through the newer financial rails which are emerging. Once again, this is likely a product most useful to emerging markets, those living under oppressive regimes, currencies suffering from high inflation, and countries who rely on the dollar as their currency, and within digitally native metaverse applications. These are *enormous* global uses though. The use in the west is prominently for ‘traders’ on exchanges at this time. /par The caveat of such products is that such ‘units’ of money can be frozen by the issuer, and they are subject to the third party risk of the issuer defaulting on the underlying instrument, instantly wiping out the value.

Klages-Mundt et al. wrote a paper in 2020, which explains the details of the different mechanisms and risks.

The following text paraphrases Spencer noon of on-chain analytics company “OurNetwork”, who provides an useful summary of the paper. *There are two major classes of stablecoins:*

- *Custodial: entrusted by off-chain collateral assets like fiat dollars that sit in a bank. Requires trust in third party.*
- *Non-custodial (aka decentralized): fully on-chain and backed by smart contracts & economics. No trusted parties.*

*In custodial stablecoins, custodians hold a combination of assets (currencies, bonds, commodities, etc.) off-chain, allowing issuers (possibly the same entity) to offer digital tokens of an reserve asset. The top 2 custodial stablecoins today are USDT and USDC. There are 3 types of custodial stablecoins.*

- *Reserve Fund: 100% reserve ratio. Each stablecoin is backed by a unit of the reserve asset held by the custodian. A useful example of this the USDF banking consortium.*
- *Fractional Reserve Fund: The stablecoin is backed by a mix of both reserve assets and other capital assets.*
- *Central Bank Digital Currency (CBDC): A digital form of central bank money that is widely available to the general public. CBDCs are in their nascency as today only 9 countries/territories*

*have launched them, many of them small.*

*Custodial stablecoins have three major risks:*

- *Counterparty Risk (fraud, theft, govt seizure, etc.)*
- *Censorship Risk (operations blocked by regulators, etc.)*
- *Economic Risk (off-chain assets go down in value)*

*Each can result in the stablecoin value going to zero.*

It's worth taking a look at these tokens individually, to get a feel for the trade-offs, and figure out how they might be useful for us in our proposed metaverse applications. It's important to know that these tokenised dollars and/or other currencies are issued on top of the public blockchains we have been detailing throughout. Which tokens are on what blockchains is constantly evolving, so it's not really worth enumerating specifics. In a metaverse application it would be necessary to manage both the underlying public blockchain and the stablecoin issued on top of it, making the interaction with the global financial system perversely more not less complex. In the following list of a few of the major coins, the first hyperlink is the whitepaper if it's available.

- **USDC** is a dollar backed coin issued by a consortium of major players in the space, most notably Circle, and Coinbase. It's has a better transparency record than tether but is still not backed 1:1 by actual dollars in reserve. It may or may not be a fractional reserve asset. It's well positioned to take advantage of regulatory changes in the USA, and seems to be quietly lobbying to be the choice of a government endorsed digital dollar, at least a significant part of a central bank digital currency initiative. It's too early to tell how this will work out, but it has substantial 'legacy finance backing'. It is the only stablecoin to increase slightly in value (depegging upward) in the wake of the UST implosion. This 'flight to quality' shows the advantage of the work that CENTRE put into regulatory compliance. It runs on Ethereum, Algorand, Solana, Stellar, Tron, Hedera, Avalanche and Flow blockchains. At this time USDC may be under speculative attack by Chinese exchange Binance, in favour of their own offering BUSD, and is losing market share.
- **Binance USD** is the dollar equivalent token from global crypto exchange behemoth Binance. It's released in partnership with Paxos, who have a strong record for compliance, and transparency. Paxos also offer USDP. Both these stablecoins claim to be 100% backed by dollars, or US treasures. They are regulated under the more restrictive New York state financial services and have a monthly attestation report.

- MakerDAO Dai is an Ethereum based stablecoin and one of the older offerings. It's been ‘governed’ by a DAO since 2014. ‘Excess collateral’, above the value of the dai-dollars to be minted, is voted upon before being committed to the systems’ cryptographic ‘vaults’ as a backing for the currency. These dai can then be used across the Ethereum network. Despite the problems with DAOs, and the problems with Ethereum, DAI is well liked by its community of users and has a healthy billion dollars of issuance. They may be [dangerously exposed](#) to the new crackdown in the USA, and there is internal talk of pro-actively abandoning DAI altogether.
- TrueUSD claims to be fully backed by US dollars, held in escrow. It runs on the Ethereum blockchain. They have attestation reports available on demand and claim fully insured deposits. It’s not quite that simple in that a portion of the backing is ‘cash equivalents’.
- Gemini GUSD claim reserves are “held and maintained at State Street Bank and Trust Company and within a money market fund managed by Goldman Sachs Asset Management, invested only in U.S. Treasury obligations.” which seems pretty clear.
- TerraUSD (UST) **was** a newer and more experimental stablecoin, and one of a set of currency representations within the network. It worked in concert with the LUNA token on the Cosmos blockchain in order to keep it’s dollar stability. It was not backed in the same way as the other tokens, instead relying on an arbitrage mechanism using LUNA. In essence the protocol paid users to destroy LUNA and mint UST when the price was above one dollar, and vice versa. This theoretically maintained the dollar peg. There was much concern that this model of ‘algorithmic stable coin’ is [unstable](#) [94]. The developers of the Terra tried to address this concern by [buying](#) enormous amounts of Bitcoin, which they quickly had to employ to address UST drifting downward from \$1. This failed to address the ‘great depegging’, with LUNA crashing to essentially zero, destroying some \$50B of capital. It will now likely act as a cautionary tale to other institutions considering Bitcoin as a ‘reserve asset’. An earlier version of this book highlighted the specific variation of the risk which quickly manifested.
- Tether is the largest of the stablecoins, with some \$70B in circulation, and the third largest ‘crypto’. This has been a meteoric rise, attracting the ire and scrutiny of regulators and investiga-

tors. There was considerable doubt that Tether had sufficient assets backing their synthetic dollars, but the market seems not to mind. Recently however they have transitioned to being backed by US treasury bills, a perfect asset for this use case. It's resilience against 'bank runs' was tested in May 2022 when \$9B was redeemed directly for dollars in a few days following the UST crash (more on this later). They are shortly to launch a GBP version for the UK. It's an important technology for this metaverse conversation because of intersections with Bitcoin through the Lightning network. Tether might actually provide everything needed. It's only as safe as the trust invested in the central issuer though, and we will employ the asset through the Taro technology described earlier, but it's notable and somewhat ironic that it's obviously better and more transparently backed than most banks and probably all novel fiat fintech products.

#### **4.2.5.1 The evolving US position**

In most regards the legislative front line is happening in the USA. Treasury Secretary Yellen responded to the collapse of Terra/UST saying that: "*A comprehensive regulatory framework for US dollar stablecoins is needed*". She also said that the stablecoin market is too small to pose systemic risk at this time. This is clearly an evolving situation, but the incredible consumer exposure to these risky products is likely to elicit a swift and significant response, and the timing seems right for intervention. The markets suggest that USDC will be the eventual winner.

Koning meanwhile has looked into the different regulatory approaches used by various stablecoins.

- The highly regulated New York state financial framework (Paxos, Gemini)
- Piggyback off of a (Nevada) state-chartered trust [TrueUSD, HUSD]
- Get dozens of money transmitter licenses [USDC]
- Stay offshore [Tether]

Proposed legislation specific to the concept of stablecoins has been advanced by Sen Toomey. There are many provisions in the bill, mostly pertaining to convertibility and the ever present problem of attestation of the 'backing' of these products. Mention has already been made of the major bill advanced by Sen. Lummis and Gillibrand. This bill also includes significant provision around stablecoins. Lummis said

*“Stablecoins will have to be either FDIC insured or more than 100% backed by hard assets.”*. This is good news for this section of the digital assets space.

Crucially there is also more clarity on privacy. This is a huge threat from digital money systems, and the USA is likely to lead. Remember though that none of this is yet law.

Valkenburg, the lead researcher of a US think tank in digital assets says the following: *“Stablecoin TRUST Act, is a discussion draft mostly about stablecoins, but it also has important privacy protections for crypto users broadly: it puts real limits on warrantless surveillance by narrowing what info can be collected from third parties. Last summer we fought a provision in the infrastructure bill that damaged the privacy of crypto users by expanding the broker definition (who needs to report information about transactions to the IRS) & crypto 6050I reporting (reports on business transactions over \$10,000). The winter before we fought and successfully delayed a rushed proposal from the outgoing Trump administration to mandate that exchanges collect information about persons who are not their customers, who hold crypto at addresses in wallets they control directly. the Stablecoin TRUST Act would stop these encroachments, constrain the treasury from collecting any nonpublic information unless they get a search warrant or collect only information voluntarily provided to an exchange by a customer and for a legitimate business purpose. If “voluntarily provided for a legitimate business purpose” sounds familiar to you, that’s b/c it’s the constitutional standard articulated by the Court in Carpenter describing LIMITED circumstances where warrantless searches of customer data are ok. It’s the standard we’ve advocated must also limit warrantless data collection at crypto exchanges. If exchanges must collect information about non-customers, that information is, by definition, not voluntarily provided for a legitimate business purpose.”*

#### **4.2.5.2 The evolving UK position**

As mentioned briefly in the introduction the UK has recently signalled an enthusiasm for stablecoins as “means of payment”. This is a stark reversal of their previous legislative momentum is possibly a response to the tightening of rhetoric in Europe around such assets. The Financial Services and Markets Bill. became law in July 2022. An excerpt pertaining to stablecoins can be seen in Figure 4.2.

The U.K. Financial Conduct Authority’s chief executive, Nikhil Rathi, outlined the FCA’s regulatory goals at the Peterson Institute for International Economics: *“The U.S. and U.K. will deepen ties on crypto-*

**22 Digital settlement assets: power to make regulations**

- (1) The Treasury may by regulations make such provision as they consider appropriate for the purpose of, or in connection with—
  - (a) the regulation of payments that include digital settlement assets,
  - (b) the regulation of—
    - (i) recognised payment systems that include arrangements using digital settlement assets,
    - (ii) recognised DSA service providers, and
    - (iii) service providers connected with, or in relation to, the systems and providers mentioned in sub-paragraphs (i) and (ii),  
as those terms are for the time being defined in Part 5 of the Banking Act 2009, and
  - (c) making insolvency arrangements (including administration, restructuring and any similar procedure) in respect of the systems and providers mentioned in paragraph (b).
  
- (2) In this section, “digital settlement asset” means a digital representation of value or rights, whether or not cryptographically secured, that—
  - (a) can be used for the settlement of payment obligations,
  - (b) can be transferred, stored or traded electronically, and
  - (c) uses technology supporting the recording or storage of data (which may include distributed ledger technology).

Figure 4.2: The UK signs into law regulation of digital representatives of value

*asset regulation and market developments — including in relation to stablecoins and the exploration of central bank digital currencies.”*

The timing seems right to explore the use of stablecoins in metaverse applications up the list of choices.

#### 4.2.5.3 Stables in metaverse applications

It makes a **lot** of sense to consider stablecoin transfer as the money in metaverses. USDC is furthest along this possible adoption curve. Their partnership with global payment provider Stripe has enabled global dollar transfer within Twitter for users of their ‘Connect’ platform. This leverages the Polygon chain (mentioned in the blockchain chapter). Many digital wallets can be connected from the user end, with Metamask potentially being the easiest to integrate. This has also been mentioned in the book. The downside of this for our open platform is that none of these elements are particularly open, or distributed, and the users of the platform will still need to use an exchange to get the USDC to spend. This approach makes it easier for the vendors and product providers in the metaverse applications to accept USDC, but everything else is actually harder.

## 4.3 Central bank digital currencies

If 2022 was the year of the stablecoin then 2023 is likely to be the year of the central bank digital currency (CBDC). CBDCs would likely not exist without the 2019 catalyst of Facebook Libre crypto currency project, which is now cancelled and defunct, pressure exerted on central banks by the concept of Bitcoin, and the stablecoins which emerged from the technology.

It now seems plausible that the world is moving toward a plurality of national and private digital currencies. Figure 4.3 from the Bank for International Settlement, shows the growing acceptance within central banks. Their 2022 annual economic report dedicates a 42 page chapter to the subject. Hyun Song Shin, head of research at BIS said “*Our broad conclusion is captured in the motto, ‘Anything that crypto can do, CBDCs can do better.’*“

This text from the thinktank VoxEU highlights the pressure on not to be ‘left behind’: “*Given the rapid pace of innovations in payments technology and the proliferation of virtual currencies such as bitcoin and ethereum, it might not be prudent for central banks to be passive in their approach to CBDC. If the central bank does not produce any form of digital currency, there is a risk that it loses monetary control, with greater potential for severe economic downturns. With this in mind, central banks are moving expeditiously when they consider the adoption of CBDC.*” The Atlantic Council have a website which tracks global adoption.

CBDCs are wholly digital representations of national currencies, and as such are centralised database entries, endorsed and potentially issued by national governments. The USA’s whitepaper shows the approach. Curiously only The Bahamas seem to have a successful implementation, but it is a rapidly evolving space, and many nations are now scrambling to catch up. A post on the LinkedIn page of the Bank of International Settlements highlights a research project between 20 Asian banks which settles tens of millions of dollars using CBDC tooling.

The following text is taken from the March 2021 Biden government “executive order” on digital assets, and defines the current global legislative position well.

“*Sec. 4. Policy and Actions Related to United States Central Bank Digital Currencies. (a) The policy of my Administration on a United States CBDC is as follows:*

*(i) Sovereign money is at the core of a well-functioning financial system,*

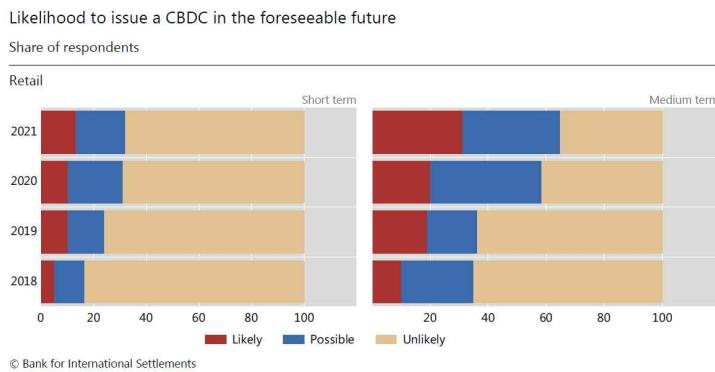


Figure 4.3: More than half of central banks surveyed by the BIS said they saw issuance of a CBDC as possible.

*macroeconomic stabilization policies, and economic growth. My Administration places the highest urgency on research and development efforts into the potential design and deployment options of a United States CBDC. These efforts should include assessments of possible benefits and risks for consumers, investors, and businesses; financial stability and systemic risk; payment systems; national security; the ability to exercise human rights; financial inclusion and equity; and the actions required to launch a United States CBDC if doing so is deemed to be in the national interest.*

*(ii) My Administration sees merit in showcasing United States leadership and participation in international fora related to CBDCs and in multi-country conversations and pilot projects involving CBDCs. Any future dollar payment system should be designed in a way that is consistent with United States priorities (as outlined in section 4(a)(i) of this order) and democratic values, including privacy protections, and that ensures the global financial system has appropriate transparency, connectivity, and platform and architecture interoperability or transferability, as appropriate.*

*(iii) A United States CBDC may have the potential to support efficient and low-cost transactions, particularly for cross-border funds transfers and payments, and to foster greater access to the financial system, with fewer of the risks posed by private sector-administered digital assets. A United States CBDC that is interoperable with CBDCs issued by other monetary authorities could facilitate faster and lower-cost*

*cross-border payments and potentially boost economic growth, support the continued centrality of the United States within the international financial system, and help to protect the unique role that the dollar plays in global finance. There are also, however, potential risks and downsides to consider. We should prioritize timely assessments of potential benefits and risks under various designs to ensure that the United States remains a leader in the international financial system.”*

In traditional nation state currencies the central banks control the amount of currency in circulation by issuing debt to private banks, which is then loaned out to individuals [95]. The debt is ‘destroyed’ on the balance sheet to remove currency through the reverse mechanism. They also facilitate government debt [96], and work (theoretically) outside of political control to adjust interest rates, in order to manage growth and flows of money.

It is somewhat surprising that Powell, chair of the US Federal Reserve has recently said “*Rapid changes are taking place in the global monetary system that may affect the international role of the dollar. A US central bank digital currency is being examined to help the US dollar’s international standing.*”. This is a rapid evolution of the narrative, with implications. It seems unlikely that the world would sacrifice the traditional banking system in favour of centrally controlled money, but many things which cannot be done with traditional nation state money systems are possible with CBDCs, because they remove the middleman of private banking between the end user and the policy makers.

- Negative interest rates are possible, such that all of the money can lose purchasing power over time, and at a rate dictated by policy. This “removal of the lower bound” has been discussed by economists over the last couple of decades as interest rate mechanisms have waned in efficacy. It is not possible in the current system, and instead money must be added through quantitative easing, which disproportionately benefits some through Cantillon effects [97, 98].
- Ubiquitous basic income is possible in that money can be issued directly from government to all approved citizens, transferring spending power directly from the government to the people. This also implies efficiency savings for social support mechanisms.
- Asset freezing and confiscation are trivial if CBDCs can replace paper cash money completely, as a bearer asset. Criminals and global ‘bad actors’ could have their assets temporarily or permanently removed, centrally, by suspending the transferability of

the digital tokens.

- Targeted bailouts for vital institutions and industries are possible directly from central government policy makers. Currently private banks must be incentivised to make cheap loans available to sectors which require targeted assistance.
- Financial surveillance of every user is possible. In this way a ‘panopticon of money’ can be enacted, and spending rulesets can be applied. For instance, social support money might only be spendable on food, and child support only on goods and services to support childcare. This is a very dystopian set of ideas. Eswar Prasad says “In authoritarian societies, central bank money in digital form could become an additional instrument of government control over citizens rather than just a convenient, safe, and stable medium of exchange[99].” This is possibly already happening in China through integration of outstanding debt data with the social credit system.
- It’s a virtually cost free medium of exchange, since there is no physical instrument which must be shipped, guarded, counted, assayed, and securely destroyed.
- The counterfeiting risk is significantly reduced because of secure cryptographic underpinnings rather than paper or plastic anti counterfeiting technologies.
- Global reach and control is instantly possible for the issuer. This is a big problem especially for a reserve currency such as the dollar. Two thirds of \$100 bills are thought to reside outside of the USA.
- System level quantitative easing and credit subsidies are made far simpler and less wasteful when centrally dictated.
- Transfer of liability and risk to the holder globally reduces the management costs for global deposits of a currency.
- It may be possible to automate the stability of a currency through continuous adjustment of the ‘peg’ through algorithms or AI.

The UK has signalled that it is not interested in developing a CBDC at this time. It is viewed as a solution in search of a problem, with the Lords economic affairs committee saying: *“The introduction of a UK CBDC would have far-reaching consequences for households, businesses, and the monetary system for decades to come and may pose significant risks depending on how it is designed. These risks include state surveillance of people’s spending choices, financial instability as people convert bank deposits to CBDC during periods of economic stress, an increase in central bank power without sufficient scrutiny,*

*and the creation of a centralised point of failure that would be a target for hostile nation state or criminal actors.”*

Meanwhile in Europe, ECB President Christine Lagarde said: “*On your question concerning CBDC, you know my views on CBDC and you know that I have pushed that project. Fabio Panetta is working hard on that together with members in the entire Eurosystem with the high-level taskforce that is working really hard on moving forward. But in a way, I am really pleased that attention is now focussed on the role that cryptos can play and the role that Central Bank Digital Currency can have when they are implemented. We have a schedule, as you know. The Governing Council decided back in October '21 to launch a two-year investigation phase, and it is at the end of that investigation phase that the decision will definitely be made to launch the CBDCs and to make it a reality. We can't go wrong with that project. I am confident that we will move ahead, but that's going to be a decision of the Governing Council. I think it's an imperative to respond to what the Europeans expect, and I think we have to be a little bit ahead of the curve if we can on that front. If we can accelerate the work, I hope we can accelerate the work. I will certainly support that and I was delighted to see that in the United States there was an executive order by President Biden to actually expect similar effort and focus and progress on CBDC, cryptos. I think that it will take all the goodwill of those who want to support sovereignty, who want to make sure that monetary policy can be transmitted properly using our currency, will endeavour.”*

India has expressed far more interest in the technology, and of course their addressable market is huge! They have published a ‘concept note’ in which they assert that a digital Rupee would be faster, cheaper, and easier to maintain. The key difference in India’s situation is the large areas of the rural population where mobile internet is more patchy. In such situations a cash equivalent stablecoin token with cash finality which can be transferred between mobile phone wallets *without* an internet connection is a huge boon. It seems very likely that India is moving to react to the innovation threat posed by cryptocurrencies to their own cash infrastructure. They are piloting the technology already. Similarly there seems to be a strong, and predictably illiberal push for transition to digital money in Nigeria. Again this is an enormous number of people, and it is hard not to be suspicious of future abuse of the system by governments.

In the USA this text from Congressman Tom Emmer shows how complex and interesting this debate is becoming. “*Today, I introduced*

*a bill prohibiting the Fed from issuing a central bank digital currency directly to individuals. Here's why it matters: As other countries, like China, develop CBDCs that fundamentally omit the benefits and protections of cash, it is more important than ever to ensure the United States' digital currency policy protects financial privacy, maintains the dollar's dominance, and cultivates innovation.*

*CBDCs that fail to adhere to these three basic principles could enable an entity like the Federal Reserve to mobilize itself into a retail bank, collect personally identifiable information on users, and track their transactions indefinitely.*

*Not only does this CBDC model raise "single point of failure" issues, leaving Americans' financial information vulnerable to attack, but it could be used as a surveillance tool that Americans should never be forced to tolerate from their own government.*

*Requiring users to open an account at the Fed to access a United States CBDC would put the Fed on an insidious path akin to China's digital authoritarianism.*

*Any CBDC implemented by the Fed must be open, permissionless, and private. This means that any digital dollar must be accessible to all, transact on a blockchain that is transparent to all, and maintain the privacy elements of cash.*

*In order to maintain the dollar's status as the world's reserve currency in a digital age, it is important that the United States lead with a posture that prioritizes innovation and does not aim to compete with the private sector.*

*Simply put, we must prioritize blockchain technology with American characteristics, rather than mimic China's digital authoritarianism out of fear."*

Most analysts now seem to think that there is little appetite to replace established 'Western' cash with CBDCs. Most significantly such products would need the support of retail banks, and it is not in their interest to service such a product. Their business model relies on using retail deposits for providing loans, and it is these deposits, not cash itself that would be the most addressable market for a CBDC. Banks don't want people to self custody money. In addition it exposes the whole banking system to a higher risk of bank runs. Such a self custody, interest bearing, central government backed asset would have significantly less counterparty risk than even bank deposits, and at times of high systemic stress it seems likely that money would flow to where it's thought safest, exposing the retail banks to runs. Fabio Panetta of the ECB said: "*If we give access to a means of payment,*

*which is relatively limited, there are no transaction costs because you only need to have a smartphone. There will be risks that people could use this possibility to move, for example, their deposits of other banks or their money out of financial intermediates.” - All of the proposed solutions to these problems such as caps and negative interest penalties seem poorly thought through. Held and Smolenski present a detailed and rigorous negative critique of the dystopian ramifications of the technology. In their conclusion they point out that: “Central bank digital currencies (CBDCs) represent an extension of state control over economic life. CBDCs provide governments with direct access to every transaction in that currency conducted by any individual anywhere in the world. As governments worldwide routinely share data with one another, individual transaction data will quickly become known to any government in a datasharing arrangement. Given the frequency with which government databases are compromised, this arrangement virtually ensures that anyone’s transaction data will eventually become available for global perusal.”*

It is (hopefully) more likely that a blend of stablecoins, private bank issued digital currency (with a yield incentive) and perhaps some limited CBDC, alongside the new contender Bitcoin, will present a new landscape of user choice. Different models of trust, insurance, yields, acceptability, and potentially privacy, will emerge.

Clearly a global, stable, wholly digital bearer asset in a native currency would be the ideal integration for money in a metaverse application, but the whole concept seems deeply ‘wrong’, and it is likely that a transition to such a technology would be complex and painful. Either way, it is certainly not ready for consideration now.

## 4.4 Bitcoin as a money

Nwosu, cofounder of Coinfloor exchange in the UK, and cofounder of the aforementioned Fedimint and says that a digital money needs the following four characteristics:

- that it be technically mature.
- it should have strong community support and network effect. We have seen that this is more simply a feature of money itself.
- that there should be regulatory clarity around the asset, a feature which even Bitcoin currently struggles with.
- it should demonstrate a core use case of ‘store of value’ which sounds simple enough, but again is contestable because of the volatility of Bitcoin.

#### 4.4.1 Spending it

Since this book seeks to examine transfer of value within a purely digital environment it is necessary to ask the question of whether Bitcoin is money. This short ‘story’, purportedly written by Nakamoto, is a fabulous look at the money values of the technology, irrespective if it’s provenance. In it is the following text: *“Here, for once, was this idea that you could generate your own form of money. That’s the primary and sole reason, is because it was related to this thing called money. It wasn’t about the proficiency of the code or the novelty, it was because it had to do with money. It centered around money. That is something people cared about. After all, plenty of projects on Sourceforge at the time were just as well coded, well maintained, if not better, by teams, and even if someone else had created the blockchain before me, had it been used for something else beyond currency, it probably would not have had much of an outcome.*

Again, irrespective of the author here, this point seems to ring true. The memetic power of Bitcoin is in its proximity to ‘money’, and the potential of the separation of money from the state.

It is beyond argument that the Bitcoin network is a rugged message passing protocol which achieves a high degree of consensus about the entries on its distributed database.

Ascribing monetary value to those database entries is a social consensus problem, and this itself is a contested topic. The most useful ‘hot take’ here is that Bitcoin behaves most like a ‘property’, while its network behaves far more like a monetary network which is created and supported by the value of the Bitcoin tokens.

Jack Mallers, of Strike presentation to the IMF identified the following challenges which he claims are solved by the bitcoin monetary network.

- Speed
- Limited transparency and dependability
- High cost
- Lack of interoperability
- Limited Coverage
- Limited accessibility

He further identifies the attributes of the ideal global money.

- Uncensorable
- Unfreezable
- Permissionless
- Borderless
- Liquid

- Digital

Mallers has recently announced USA focused partnerships which leverage his Strike product to enable spending Bitcoin, through Lightning, as Dollars in much of the point of sale infrastructure in the USA. This is a huge advance as it immediately enables the vendors both online and at physical locations to either save 3% costs for card processors, or else pass this on as a discount. Crucially for ‘Bitcoin as a money’ it also allows the vendors to receive the payment as Bitcoin, not Dollars. A possible further and highly significant feature is that it might now be possible to divest of Bitcoin in the USA, buying goods, without a capital gains tax implication. Mallers claims to have legislative backing for this product, but the devil will likely be in the detail. The likely mechanism for this product is that the EPOS partner sends a Lightning request to Strike, which liquidates some of their Bitcoin holding to a dollar denominated stablecoin, but in a tax free jurisdiction such as El Salvador. This stablecoin will then be sent to the EPOS handing partner such as NCR. Stablecoin to Dollar transactions in the USA are much murkier and likely don’t cost anything for these companies. This agent will then authorise the Dollar denominated sale to the American digital till. Crucially nobody has a US capital gains tax exposure in this chain, and all of the settlements were near free, and instantaneous, with ‘cash finality’ for everyone except the EPOS company. They are likely actually exposed to a small risk here because uptake will be very low level. The novelty opportunity will likely cover any potential exposure to stablecoin collapse. This is a radical upgrade on the normal flow of divesting Bitcoin for American users.

Using this open product to spend Bitcoin as Bitcoin to vendors might be available through Shopify globally. Again, it’s too new to be sure. Promisingly a Deloitte study has found that 93% of businesses accepting Bitcoin have seen revenue and brand perception improve, and 75% of USA sales execs plan to accept digital assets at some point in the next 2 years. This ambition in the US markets is likely to benefit from the proposed \$200 tax exempt law for purchasing goods and services with Bitcoin.

Of these recent developments in Lightning Lyn Alden says: *Some people naturally dismiss [strike] because they don’t want to spend their BTC; they want to save it. However, the more places that accepted BTC at point of sale (on-chain or Lightning or otherwise), the more permissionless the whole network is. This is because, if all you can do with BTC is convert it back into fiat on a major exchange, then it’s easy to isolate it, effectively blacklist addresses, etc. But if you can directly*

*spend it on goods and services across companies and jurisdictions, it's harder to isolate. There are now plenty of vendors that make this easy for merchants to implement, and the merchant can still receive dollars if they want (rather than BTC), or can decide their % split. Since it's an open network, anyone can build on it, globally. And then when you add fiat-to-BTC-to-fiat payments over Lightning, it gets even more interesting because it doesn't necessarily need to be a taxable event. Lightning wallets with a BTC balance and a USD/stablecoin balance. Lower fees than Visa and others.*

#### 4.4.1.1 Bitcoin based FIAT

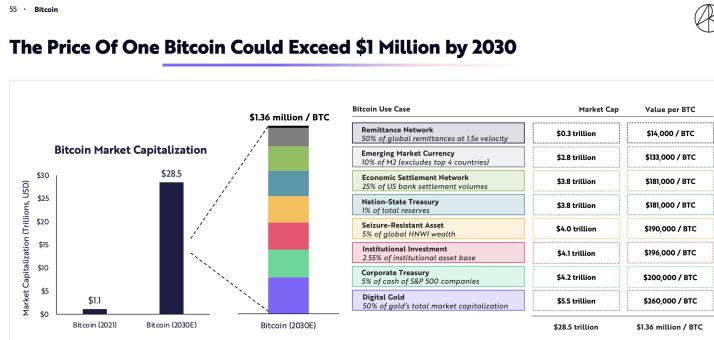
More interestingly for metaverse applications Mallers has opened this section of the company to interact with the public Lightning network, allowing people with a self hosted wallet or node to pay directly for goods across America, settling immediately in Dollars, using their Bitcoin, at zero cost. **This opens the possibility to buy from US based (Dollar denominated) metaverse stores, using the capabilities of the stack assembled at the end of the book.** The implications globally are unclear at this time.

Stablesats is another approach which uses exclusively lightning bitcoin but makes the value stable against the US dollar using an algorithm. This is a very interesting option and will be explored in detail at some point.

#### 4.4.2 Saving with it

The Bitcoin community believes that Bitcoin is the ultimate money, a 'store of value', chance to separate money from state, increase equality of opportunity and ubiquity of access, while others view it as 'rat poison', or a fraudulent Ponzi scheme [100]. A notable exclusion from the negative rhetoric is Fidelity, the global investment manager, who have always been positive and have recently said: "*Bitcoin is best understood as a monetary good, and one of the primary investment theses for bitcoin is as the store of value asset in an increasingly digital world.*"

The following paraphrases Eric Yakes, author of 'The 7th Property'. Again, this is an Austrian economics perspective, and like much economic theory the underlying premise is contested[101]: "*Paper became money because it was superior to gold in terms of divisibility and portability BUT it lacked scarcity. People reasoned that we could benefit from the greater divisibility/portability of paper money as long as it was redeemable in a form of money that was scarce. This is when*



Forecasts are inherently limited and cannot be relied upon. For informational purposes only and should not be considered investment advice, or a recommendation to buy, sell or hold any particular security or cryptocurrency. Source: ARK Investment Management, LLC, 2021. 1 Corporate Treasury Data Source: Capital IQ, Resilient Asset Data Source: https://www.worldwealthreport.com/wp-content/uploads/sites/1/2020/09/World-Wealth-Report-2020.pdf. Resilience Multiplier: The Ark Big Ideas Report estimates that the current market value of Bitcoin is \$1.36 million / BTC. This is based on the assumption that the Ark Resilience Multiplier of 2020 (2020 Nov 2) price multiplier was applied to Nation-state treasury and corporate treasury opportunities. The price multiplier is the upper bound estimate made by Chris Burniske (Co-author of Cryptoeconomics: The Innovative Investor's Guide to Bitcoin and Beyond and Head of Ark Invest) in 2020, which roughly equals to the average between the estimated lower bound made by Citi Bank (<https://medium.com/@burniske/cryptoeconomics-flow-amplification-reflexivity-7d008f50d0c>)

Figure 4.4: Potential market exposure to Bitcoin as a money

*money needed to be “backed” by something.*

*Since we changed money to paper money that wasn’t scarce, it needed to be backed by something that was. Since the repeal of the gold standard, politicians have retarded the meaning of the word because our money is no longer backed by something scarce.*

*So, what is bitcoin backed by? Nothing.*

*Sound money, like gold, isn’t “backed”. Only money that lacks inherent monetary properties must be backed by another money that maintains those properties. The idea that our base layer money needs to be backed by something is thinking from the era of paper money. Bitcoin does not require backing, it has inherent monetary properties superior to any other form of money that has ever existed.”*

The 2022 ARK Big Ideas report again provides some useful market insight. They posit that demand for the money features of Bitcoin could drive the price of the capped supply tokens to around 1M pounds per Bitcoin as in Figure 4.4. Take this with the usual pinch of salt, as Ark have been performing notably badly lately with their predictions. Perhaps more than any of these takes, it is worth considering the current public perception of the technology as a money and store of value. This twitter thread from professional sportsman Saquon Barkley, to his half million followers on the platform, captures the mood. He is one of a handful of athletes now being paid directly in Bitcoin.

*“I want my career earnings to last generations. The average NFL career is 3 years and inflation is real. Saving and preserving money over time is hard, no matter who you are. In today’s world: How do we*

*save? This is why I believe in bitcoin. Almost all professional athletes make the majority of their career earnings in their 20s. With a lack of education, inaccessible tools, and inflation, a sad yet common reality is many enter bankruptcy later on. We can do better. We need to improve financial literacy. Bitcoin is a proven, safe, global, and open system that allows anyone to save money. It is the most accessible asset we've ever seen.”*

This ubiquity of access is what probably most distinguishes Bitcoin. Previously it could be argued that only the most wealthy could access the ‘means’ to store their labour without loss of value over time (through inflation). To be clear, inflation is an important part of the money system, somewhat within the control of the central banks, and approximate to taxation. It applies equally to all holders of the money supply. Asserting that money should be replaced by a ‘hard asset’ such as Bitcoin, in the place of the more controllable utility of money, is likely both a fantasy, and wrong minded. This conflation of money and property is a confusion caused by Bitcoin’s proximity to money, and it’s ‘money like’ network, and is extremely commonplace.

These narrative takes are all rooted in the popular idea that Bitcoin is a ‘hedge against inflation’; an increasingly fragile take, as the price plummets with global markets. The Bitcoin community seems somewhat confused about the nature of money, which is predictable because we can see in these sections that money is pretty confusing. Money is the fluid, elastic [102], and thin ‘working credit’ layer on top of historical human production, which provides transaction convenience, and tools for credit. Value is effectively swapped in and out of this layer through the actions of central banks, controlling inflation into acceptable margins. Simplistically this is done through manipulation of interest rates (the easiness of credit), quantitative easing (buying of assets) and quantitative tightening (selling of assets). It is primarily *not* a long term store of value, as Austrian economists perhaps believe it should be. This function is left to assets. The Austrian thesis of ‘hard money’ (which cannot be ‘debased’ by government action) seems somewhat naive when one considers that if credit exists anywhere in the world (ie, the creation of paper money through loans) then this would be used to buy up a hard money asset in the long run, causing a scarcity crisis. This is what happened to gold in the middle of the last century.

Fundamentally, Bitcoin isn’t money (in the traditional sense) because it’s not an IOU, which money certainly is. It’s a bearer instrument, novel asset class, with money like properties, as identified above. As

said again and again it functions most like a ‘property’ which can be invested in by anyone, with all the attendant risks of that property class to the holder. Lyn Alden says it sits somewhere between a saving tool, and an investment, acting as “programmable commodity money”.

Andrew M. Bailey says *“in an ideal world where governments honour the rights of citizens, they don’t spy, they don’t prohibit transactions, they manage a sound money supply, and they make sound decisions, the value of bitcoin is very low; we’re just not in an ideal world”*

Another potentially important differentiating affordance is censorship resistance. There’s really nothing else like it for that one feature. With that said Bitcoin is only a viable ‘money like thing’ when viewed in the layers described in this book, and elsewhere[103]. The base chain layer is an apex secure store of value. Whatever layer 2 ultimately emerges is the transactional layer which could replace day to day cash money, while the hypothetical layer 3 might be useful for complex financial mechanisms and contracts operating automatically, and also provides the opportunity for using the security model of the chain to support other digital assets, including government currencies through stablecoins. All these things have a natural home in borderless social spaces.

## 4.5 Risks (money, not technical)

Special thanks to economist Tim Millar for help with this section.

### 4.5.1 Risks to Bitcoin the money

#### 4.5.1.1 Geopolitics

It can be seen that following the invasion of Ukraine by Russia, that sanctions of various kinds were applied to the Russian economy. One of these was the previously discussed Swift international settlement network. Another whole category was the removal of support by private businesses domiciled outside of Russia and Ukraine, and pertinent here is that VISA, Mastercard, Paypal, and Western Union all removed support for their product rails. This means that while some cards and services still work, and will likely work again through Chinese proxies in the coming months, considerable disruption will be felt by Russian companies and individuals. This is not to say that this disruption is necessarily wrong, but it is clear now that all of these global financial transfer products and services are contingent on political factors. The same might be true of CBDC products if they gain traction globally.

There is certainly no reason why all money within a physically delineated border could not be blocked or cancelled. This is not as true for Bitcoin at this time.

However, with enough political will it is technically plausible to incentivise miners with additional payments to exclude transactions from geolocated wallets. This would be mitigated by Tor, and in a global anonymous network it is very likely that a miner could be found at a higher price for inclusion in the next block.

We have already seen much negative political positioning related to the energy concerns in an earlier chapter. There are similar noises coming from policy makers with regard to the money utility of the technology. The United Nations have made the following recommendations: *“Developing countries may have less room to manoeuvre, yet the regulation of cryptocurrencies is possible. The following policies, among others, have the potential to curb the further spread of the risks of cryptocurrencies and stablecoins:*

- *Ensuring comprehensive financial regulation, through the following actions:*
  - *Require the mandatory registration of crypto-exchanges and digital wallets and make the use of cryptocurrencies less attractive, for example by charging entry fees for crypto-exchanges and digital wallets and/or imposing financial transaction taxes on cryptocurrency trading;*
  - *Ban regulated financial institutions from holding stablecoins and cryptocurrencies or offering related products to clients;*
  - *Regulate decentralized finance (such finance may, in fact, not be fully decentralized, given its central management and ownership, which form an entry point for regulation);*
- *Restricting or prohibiting the advertisement of crypto-exchanges and digital wallets in public spaces and on social media. This new type of virtual, and often disguised, advertisement requires policymakers to expand the scope of regulation beyond traditional media. This is an urgent need in terms of consumer protection in countries with low levels of financial literacy, as even limited exposure to cryptocurrencies may lead to significant losses;*
- *Creating a public payment system to serve as a public good, such as a central bank digital currency. In the light of the regulatory and technological complexity of central bank digital currencies and the urgent need to provide safe, reliable and affordable pay-*

*ment systems, authorities could also examine other possibilities, including fast retail payment systems.*

This is tough talk. We have seen that the IMF is willing to make their loans contingent on such regulation. This global response to the technology is a significant headwind, but like the internet itself, it's very hard to actually stop these products being used.

#### 4.5.1.2 Capture by traditional finance

As the popularity of Bitcoin continues to grow, traditional financial market incumbents have begun to take notice. In an effort to assert their dominance and protect their interests, these incumbents have turned to regulation and acquisition as means of capturing the growing markets. This is most clear in the 'alt coin' space where traditional banks have leveraged their knowledge and marketing to transfer money from retail investors into their own venture capital operations. This is not to say that Bitcoin is immune from these harms.

One way that traditional financial market incumbents have sought to capture the bitcoin market is through the use of regulatory frameworks. By working with government agencies (as described in previous chapters), to develop and implement regulations governing the use and trade of cryptocurrencies, these incumbents are able to limit competition and control the flow of capital into and out of the markets. They are also able to "print paper bitcoin", running a fractional reserve operation, as happened in the FTX/Alameda fiasco.

We have already described how, in the United States, the Securities and Exchange Commission (SEC) has implemented regulations governing the issuance and trading of bitcoin-based securities. These regulations, which require issuers of bitcoin-based securities to register with the SEC and comply with a variety of reporting and disclosure requirements, have effectively made it difficult for small and independent players to enter the market.

Another way that traditional financial market incumbents have sought to capture the bitcoin market is through the use of partnerships and acquisitions. As the newer companies stumble and fail as a result of poor risk management and over-leverage it seems that Wall Street incumbents like Goldman Sax are taking advantage of the opportunity at structural scale. By acquiring existing crypto companies, these incumbents are able to gain access to the technology, expertise, and customer base of these companies, giving them a significant advantage over their competitors.

For example, in 2017, the Chicago Mercantile Exchange (CME)

partnered with the CBOE to launch bitcoin futures trading. This partnership allowed the CME and CBOE to tap into the growing market for bitcoin derivatives, while also providing a means for traditional financial market participants to gain exposure to bitcoin without having to hold the underlying asset. This is a crucial risk to the emerging technology as ownership of the underlying asset (self custody) was supposed to be the whole point of the technology. Ben Hunt of epsilon theory recently said: *“..if you don’t see that the crypto quote-unquote industry has become just as blindingly corrupt as the traditional Financial Services industry it was supposed to replace well you’re just not paying attention what made Bitcoin special is nearly lost and what remains is a false and constructed narrative that exists in service to Wall Street in Washington rather than in resistance; the Bitcoin narrative must be renewed and that will change everything”*

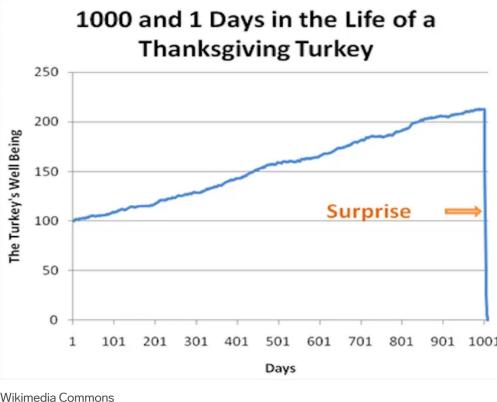
#### **4.5.1.3 Liquidity Lottery**

Because holders of BTC are disincentivised to sell the asset (assuming future gains) it is likely vulnerable to something Kao called the ‘liquidity lottery’. This is a supply/demand mismatch which he thinks could spell the end of the asset class in time. Macro analyst group ‘Doomberg’ believe that this mispricing of the asset is the significant risk, and point out that if Bitcoin is approached within the framework of government controlled Fiat, then there is no ‘there there’. Bitcoin does not generate more fiat money within its ecosystem (as say an energy extraction company would), and as such is very suggestive of the features of a Ponzi. The value is dependent on finding the ‘greater fool’ mentioned near the start of the book. Doomberg assert that the price of the asset has been inflated by manipulation in the unregulated stablecoin markets (specifically Tether), and in the event of a ‘run for the exits’ there would be a serious repricing. This seems entirely possible, and perhaps even likely, below an unknown threshold of confidence.

#### **4.5.1.4 Manipulation of price or the network**

Bitcoin is still young and illiquid enough to be highly manipulable. Imagine for instance if a major organisation or nation state wished to accumulate a significant amount of the asset, but would prefer a lower price.

There is an unknown level of exposure to risk from centralised mining. If a few of the major mining pools were simultaneously infiltrated by a nation state actor then it might be possible to engineer a ‘deep re-org’ of a large transaction. This would be dealt with quickly and



Wikimedia Commons

Figure 4.5: Nassim Taleb's Turkey Problem

almost certainly be a transient attack, but the damage to the narrative might be substantial. The proposed solution to this known vulnerability is called ‘Stratum V2’ in which the transaction in the blocks would be organised by pool miners or their delegates, with an increase in efficiency as a driving incentive. A similar vulnerability exists in the centralisation at the level of internet service providers [70]. This or some other flaw might lead to a selling cascade. Nobody knows just how vulnerable to selling cascades Bitcoin might be against a really serious challenge by an empowered actor, but it’s already high volatility is suggestive of risk.

#### 4.5.1.5 Rehypothecation

It’s vulnerable to rehypothecation (paper bitcoin managed by centralised entities running a fractional reserve). It seems that Figure 4.5 by Nassim Taleb is a cautionary tale [104].

#### 4.5.1.6 Scale

Scalability is always going to be a problem for Bitcoin, for all the reasons discussed in the blockchain chapter. There is no “ready to go” solution (except perhaps federations) that could onboard the whole world at this time because of the limited number of available UTXOs.

Finally, a lack of fungibility, and privacy by default in Bitcoin, trends towards blacklists and over time this could seriously compromise the use of the asset.



Figure 4.6: Cycle theory revisited blog post [Image used with permission]

#### 4.5.1.7 Centralisation of the money over time

In a medium term future it's possible to imagine a smart enough autonomous AI or ML actor managing to accrue Bitcoin through fast and smart 'decisions'. This could unreasonably centralise the asset, and it would be impossible to claw this situation back. These constructs would last for the lifetime of the chain unless constrained by timelock multisigs for instance.

#### 4.5.2 Bitcoin externalities

This section is the risks that Bitcoin poses to external money systems, but it's worth pointing out that a risk to wider society is clearly *also* a risk to Bitcoin itself.

##### 4.5.2.1 Inherent volatility

One of the better public analysts of the asset, sees the price eventually fluctuating somewhere between \$700k and \$300k. Figure 4.6. This is not how a money is supposed to work.

Neither though is it the endless "number go up" that speculators have been promised. The aims of the project have a cognitive dissonance right at the core. The volatility trends toward:

##### 4.5.2.2 Unfair distribution

By design the distribution of Bitcoin is likely 'fair', in that everyone has been able to access and secure the asset long term without prejudice.

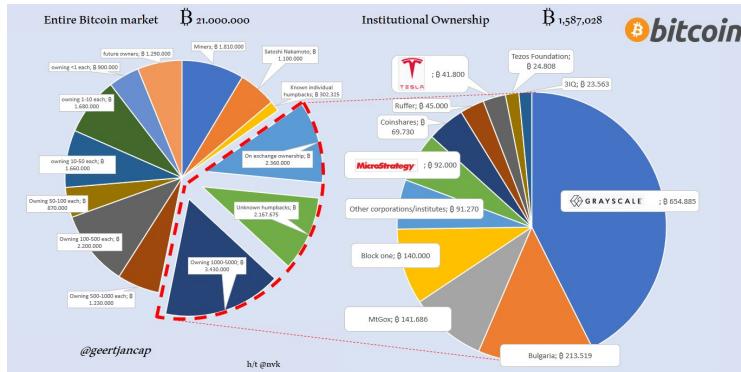


Figure 4.7: Bitcoin distribution is skewed to a few early holders, but it likely is fair. [Image used with permission]

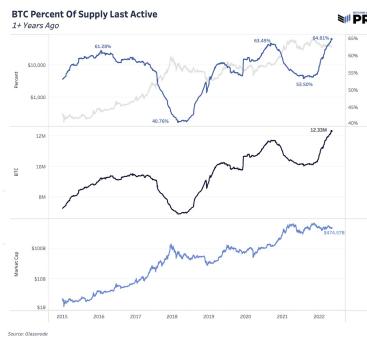


Figure 4.8: Supply of bitcoin that hasn't moved for over 1 year

Figure 4.7 from Twitter user @Geertjancap shows the distribution in 2021. Whether this is judged to be fair if the asset jumps to 10 times its current value, minting a new class of hyper rich holders, is another matter. This pressure to emulate the early winners leads to:

#### 4.5.2.3 Endless HODL

It's possible that there's a problem with people not wanting to sell the asset, because they are predisposed to a particular fervour promoted within the community. This can be seen in the glassnode data, where the black line in Figure 4.8 shows that the asset held for more than a year (illiquid) has increased over the years. There's real recalcitrance

about using the asset as a money, which leads to:

#### **4.5.2.4 Reduction of funding source / liquidity in legacy finance**

In the current financial system remuneration for labour performed in the workforce is loaned into the money system, where it's put to work providing liquidity for creation of more opportunity. This system actually works pretty well. The more of this deferred labour that's taken out of the legacy system, the less work can be done with what remains. This isn't to say that Bitcoin will cause a liquidity crisis, but there is possibly a cost if the current trend continues. This isn't as bad as:

#### **4.5.2.5 Bitcoin collapse system shock**

In the event of an existential collapse of the Bitcoin network the erasure of so much capital would certainly have a contagion effect on the whole global financial system. It's hard to imagine what such an event could be, this being the nature of "black swans". One cited example is the unravelling of cryptography by quantum computing. Some conspiracy theorists in the past have even speculated that Bitcoin is itself a canary in the coal mine, engineered by the NSA to warn about emergent quantum computing somewhere in the world. It's all pretty silly because without cryptography Bitcoin would be the least of humanities problems. The risk of 'something' does exist though. The same anti-fragile feature can't be said about the technologies around Bitcoin, which gives us:

#### **4.5.2.6 Stablecoin collapse system shock**

This is much more likely. Stablecoins are under regulated, centralised, under collateralised, ponzo like structures, which could quite clearly fall apart at any point. The contagion effects of this are unclear as they're not yet too significant. They're a risk nonetheless, and may be an indicator of:

#### **4.5.2.7 Tech for techs sake yielding unexpected outcomes**

The whole question of what Bitcoin addresses, whether it's been properly thought about, what the end goals are, and what the risks are is significant. It's a computer science and engineering solutions gone completely wild. It's clearly got benefits and there's clearly human appetite for this technology, but it's probably running ahead of the knowledge base around it. This is most exemplified in:

#### 4.5.2.8 No agreed measurable end goal

Bitcoin is a game theoretic juggernaut, where success of the network breeds more success for the network. This was obviously a great design choice for the computer scientists trying to solve the problem of a secure, and scalable, electronic cash, which couldn't be confiscated. Ironically for a global consensus mechanism it seems that nobody wants to discuss what constitutes a successful end point to this, and especially not what 'successful' endpoints for the game theory which have calamitous negative repercussions for wider society look like. This might have implications for:

#### 4.5.2.9 National security / actual warfare

There's some national security implications for Bitcoin which are discussed both in the fringes and the sector media. Essentially, the industrial mining complexes which are more commonplace now, are easily identifiable targets, and provide nations with both some leverage over the global network, and a considerable source of income. The IMF correctly identifies these facilities as a way for nation states to monetise their energy reserves without the need for foreign markets, opening the door to sanction avoidance. In the case of smaller and developing nation states who are perhaps subject to financial penalties on the global stage for whatever reason, these facilities start to look like legitimate targets for cyber and conventional warfare. This 'weaponisation' of a neutral technology is already manifest in:

#### 4.5.2.10 Bitcoin as a culture war foil

Bitcoin's online community skews very hard toward right wing libertarianism. This isn't to say there are no other voices, but they are certainly outnumbered. This imbalance is almost certainly a product of the ESG concerns around the technology. There has been a notable increase in diversity of thought since the evolution of the energy narrative, but it persists. This leads to a paucity of voices in policy making circles, and in the USA a strong delineation between policy makers along party lines. This kind of thing tends to be self reinforcing, and it seems very possible that the global liberal left will swing mainly against the technology, while the neoliberal right will be attracted more to it. As tensions increase so it seems does the online rhetoric. Even scientists now seem to agree that Bitcoin investors are calculating psychopaths [105]. This leads to:

#### 4.5.2.11 Self reinforcing monocultures

There are some powerful ‘pockets’ of fringe thinking within the vocal, online, Bitcoin communities. The most palatable of these are figures like Michael Saylor, Elon Musk and Jack Dorsey, but there’s whole subcultural intersections around antivax, anti-woke, anti cancel culture, and fad diets. There are a disproportionate number of adherents of the failed global “neocon” experiment [106], and not a few outright bigots. It might seem that this isn’t terribly important, but Bitcoin viewed through the lens of these of these communities looks pretty strange to the newcomer. The early adopters are just using their wealth to leave the battlefield behind using:

#### 4.5.2.12 Jurisdictional / legislative arbitrage

The reach of Bitcoin and it’s ability to undercut the global money systems, delivering savings for those with a first mover advantage, and the current paucity of agreed legislation has set up an interesting and rare condition. Bitcoin encourages something called jurisdictional arbitrage; the race to take advantage of the variance in national approaches to the asset class. This section could perhaps be explored as a list of opportunities, but from the viewpoint of our SME business use case it’s far more likely that these destabilising ‘features’ are risks:

- **Difference in ‘crypto’ profit models.** Countries and jurisdictions can apply different charges for use of trading platforms and capital gains tax enjoys huge variance. Some countries are now competing to offer zero tax as a way to attract valuable tech mind share.
- **Income tax** is harder to monitor in a truly international context. This is variously pitched around the world. It’s hard to monitor this stuff and tax at source like with company employees wages, because it’s basically designed to be hard to monitor. This results in:
- **Passport perks.** Countries are already selling residence and company rights against Bitcoin marketing. There’s a lot of new ways to buy passports and citizenship based on ‘inclusion’ in this community now. It’s a terrible look. The early adopters can live international jetsetter lifestyles and ca benefit from:
- **Business subsidies** such as those appearing in Switzerland, Honduras, El Salvador, Africa etc. This means a new divide is emerging since some countries are in instead applying:
- **KYC/AML** rules which make onboarding into this technology harder. Currently there’s a trend toward globally capturing in-

formation about people buying these assets, but it's effectively tech warfare now with engineers, rapidly producing tools to circumvent slow and varied legislation. The best example of this remains El Salvador, where Bitcoin is legal tender, and has perhaps kickstarted:

- **Bond issuances.** El Salvador are having a faltering start to their promised bond issuance. It might be that all of this is a harbinger of the rise of:
- **The Network State** is a proposal by Srinivasan [107]. His is a transhumanist thesis which he describes: *"The fundamental concept behind the network state is to assemble a digital community and organize it to crowdfund physical territory. But that territory is not in one place — it's spread around the world, fully decentralized, hooked together by the internet for a common cause, much like Google's offices or Bitcoin's miners. And because every citizen has opted in, it's a model for 100% democracy rather than the minimum threshold of consent modeled by 51% democracies."*

#### 4.5.2.13 Hyperbitcoinization

All of the above starts to look like convergence on something the crypto community regularly describes to itself within its internal media. Hyperbitcoinization is a term coined in 2014 by Daniel Krawisz [108]. It is the hypothetical rise of Bitcoin to become the global reserve currency, and the demonetisation of all other store of value assets. This seems unlikely but is hinted at in a game theoretic analysis of both Bitcoin and current macro economics. Again, Bitcoin is a likely very poor replacement for money. The ability to monetise assets through banks, backed by law and contracts (the debt based system), is a highly refined human concept, while Bitcoin is a fusion of Austrian economics, and a computer science project. The hyperbitcoinization idea finds its ultimate expression in Svalholm's "Everything Divided by 21 Million", a hypothetical re-accounting of all human production into the Bitcoin ledger [109].

Nobody is sure what a regular deflationary cycle might do to global supply chains. Malherbe et al. point out the inherent unsuitability of a deflationary asset such as Bitcoin as the global reserve currency [110] and feel that perhaps other cryptocurrencies might be more suitable for adoption by governments. Interestingly this is the only paper to reference 'Duality' (the only thing purportedly written by Satoshi Nakamoto after they left the project).

Writer and activist Cory Doctorow is not a fan of Bitcoin. He provides an excellent summary of what he sees as the basic societal mistake of the libertarian ideals around strong property rights and hard money. In a hyperbitcoinised world where debt law would be enforced by distributed code, it might be far harder to prevent the “fall of Rome” scenario he describes.

Fulgur Ventures (a venture capital firm) provide a blog post series about the route this might take. It’s important to note that Budish suggested that the usefulness of Bitcoin (and blockchain) cannot exceed the cost to attack it. This is highly suggestive that hyperbitcoinisation is impossible [111]. It’s beyond the scope of this book to look at the implications of all this.

## **4.6 Does DeFi matter to SMEs**

DeFi is decentralised finance, and might only exist because of partial regulatory capture of Bitcoin. If peer-to-peer Bitcoin secured yield and loans etc were allowed then it seems unlikely that the less secure and more convoluted DeFi products would have found a footing. DeFi has been commonplace over the last couple years, growing from essentially zero to \$100B over the last two or three. It enables trading of value, loans, and interest (yield) without onerous KYC. If Bitcoin’s ethos is to develop at a slow and well checked rate, and Ethereum’s ethos is to move fast and break things, then DeFi could best be described as throwing mud and hoping some sticks. A counter to this comes from Ross Stevens, head of NYDig who says *“The concept of decentralized finance is powerful, noble, and worthy of a lifetime of focused effort.”*. This may be true in principle, but certainly isn’t the case as things stand.

According to a recent JPMorgan industry insider report, around 40% of the locked value on the Ethereum network is DeFi products. It is characterised by rapid innovation, huge yields for early adopters, incredibly high risk, and a culture of speculation which leads to products being discarded and/or forked into something else in the pursuit of returns. Ethereum also allows miners of the blockchain to cheat the system [112].

Much of the space is now using arcane gamification of traditional financial tools, combined with memes, to promote what are essentially pyramid schemes. Scams are very commonplace. Loss of funds though code errors are perhaps even more prevalent.

The Bank for International Settlements have the stated aim of

supporting central banks monetary and financial stability. Their 2021 report on DeFi noted the following key problems.

- ..a “decentralisation illusion” in DeFi due to the inescapable need for centralised governance and the tendency of blockchain consensus mechanisms to concentrate power. DeFi’s inherent governance structures are the natural entry points for public policy.
- DeFi’s vulnerabilities are severe because of high leverage, liquidity mismatches, built-in interconnectedness and the lack of shock-absorbing capacity.

These are two excellent and likely true points. European Parliament Vice President Eva Kaili made this same point at the World Economic Forum, so clearly regulators are aware of the lack of meaningful distribution in DeFi. In addition access to DeFi is ‘usually’ through Web2.0 centralised portals (websites) which are just as vulnerable to legal take-down orders as any other centralised technology. Given who the major investment players seem to be in this ‘new’ financial landscape it seems very likely that regulatory capture is coming. The seemingly unironic trend towards CeDeFi (centralised decentralised finance) illustrates this; it’s all likely a fad.

There are more recent DeFi on Bitcoin contenders, but these are vulnerable to the same attacks and problems in the main.

There is likely no use for this technology for small and medium sized companies on the international stage. It is far more likely that reputation would be damaged. The ‘best’ of the portfolio of DeFi offerings is perhaps high yield stablecoin accounts, where dollars equivalent tokens are locked up providing very high return rates of up to 20 percent. It’s also possible to get loans (by extension business loans) out of such systems at relatively low risks. The best ‘distributed’ example of this is probably Lend, at HODLHODL, which is a peer-to-peer loan marketplace. Atomic Finance leverages discrete log contracts amongst other more edge uses of Bitcoin, to provide financial services without custody of the users’ Bitcoin. It is possible to make the argument that between hodlhodl loans, taro asset issuance, boltz exchange, and lightning escrow that all of the “classes” of DeFi smart contract can be serviced already by Bitcoin alone.

Many more custodial options exist for loans (CASA, BlockFi, Nexo, Ledn, Abra etc). These might not really fit the definition of DeFi at all. Many of these centralised DeFi companies (CeDeFi) have imploded in the wake of the Terra/Luna collapse since they were generating yield from one another and ultimately Terra. The maxim seems to be that if

you don't know how the system is monetised then you are likely the product. DeFi itself weathered the recent market turmoil comparatively well and it's possible that as these products evolve they may be useful to companies who have Bitcoin and stablecoins on their balance sheet long term. Dan Held maintains an online spreadsheet which compares these products.



## 5. Distributed Identity & Trust

For distributed Web3, and by extension metaverse applications to flourish it is necessary to solve the identification problem [113]. Without a solution to this bots, scammers, and AI actors will reduce usefulness and usability of and already quite arcane user experience.

This chapter is an oddity because most of traditional DID/SSI isn't really fit for purpose. Distributed self sovereign identity has a great elevator pitch though. Individuals should be empowered through technology to manage their own data, without manipulation or exploitation by centralised corporate behemoths. In practice it's a staggeringly complex proposition which increases risk to the individual, decreases convenience, and despite much work, does not even make much sense in it's own terms. Webs of trust are viable so this means Nostr, Marking, or Slashtags which will be discussed, but are early products. Thanks to Melvin Carvalho for advice with this section.

### 5.1 Applications of DID/SSI

Some of the likely, and discussed applications for DID/SSI are the more inherently private and personally valuable sets of data an individual might generate throughout their life. The theory is that subsets of such data could then be digitally revealed by the individual when required, and that cryptographic verification built into the system would

guarantee the veracity of the data to the receiving party. It is also possible to make use of “zero-knowledge proof” such that assertions can be made about the contents of the data without revealing the data itself. A good example of this is an age verification challenge, where a threshold age could be asserted without necessarily revealing the date of birth. Other keystone uses of the technology are:

- health documents history
- qualifications and certifications
- financial record and relationships with those of others
- contacts, connections to other people and their appropriate data, including things like shared and personal calendars

It's also possible to extend this key management ethos to all login credentials, and all data currently stored on centralised servers. This is the tension discussed in the chapter about Web3. Proponents think that using something like a DID/SSI stack to manage encryption, decryption and access to data within cloud services gives the user the best of all worlds. They see simply logging in with a cryptographic wallet, and using that same public/private key pair to manage the data beyond as some kind of panacea. This is very complex stuff though, and it seems very likely they just haven't thought this through enough.

## 5.2 Classic DID/SSI

Distributed identity / self sovereign identity has been extensively researched for decades, with hundreds of peer reviewed papers, and extensive support from the world wide web consortium. The academic field now seems quite ossified and has settled on a couple of hundred ‘schema’ which they feel underpin the next layer of development. It is a *complex field*, and the language and diagrams are arcane and self referential as seen in Figure 5.1. . Moreover the minimal implementation of such proposed systems hints at a federated model of centralised/federated ‘truth’ to enable persistence of identifiers over time.

The major failing of the DID/SSI work to date is a lack of meaningful use cases with incentives for adoption. This is clearly explained by Lockwood [114] who proposes that the pathway to adoption of ‘classic’ DID/SSI requires an incentive over and above the current identity management on the web. Being distributed is not enough. Especially in the light of questionable assurances of this even being true.

Perhaps most concerning is this *recent exchange* on the mailing lists. Here, two long standing developers of DID say the following:

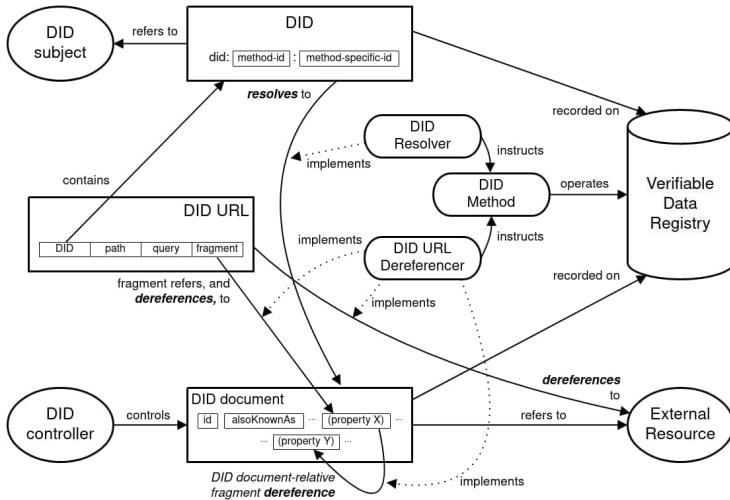


Figure 5.1: Part of the DID SSI specs

*“Not a single entity I know that’s doing production deployments has actually vetted did:ion and found it to be production capable. This goes for every DLT-based DID Method out there - even the one we’re working on. I am highly sceptical of anyone that says that any DID Method is ready for production usage at present.*

*Agreed — as one of the proponents of DLTs (in particular permissionless public ones) none are mature enough yet for production.”*. It seems then that we can rule out use of these technologies?

### 5.2.0.1 DID principles

The core principles of distributed identity are that there should be persistent identifiers, like real world documents which assert identity, but with extended use cases. These should be permanent, and resolvable everywhere, forever. Underpinning this is cryptographically verifiable and decentralised data, managed by the user, or their trusted proxy. As primitives this makes them lifetime digital assets, that are portable, and unconfiscatable, with no required reliance on a trusted third party. By this stage in the book you should be familiar with these concepts, but application of this fundamental mindset to all personal data and digital interactions is a bigger reach even than money and value.

### 5.2.0.2 What's in a DID document?

All classic DID is underpinned by a DID document what bootstrap the services it's connected to. It is made up of one or more public keys. The documents can make use of services such as timestamps, cryptographic signatures, proofs, delegations, and authorisations. They should contain the minimum amount of information to accomplish the specific task required of them.

## 5.3 Newer Technologies

This section about newer technologies is perhaps best summarised by Jack Dorsey, ex CEO of twitter, paraphrased here:

*"I'll start with the principles I've come to believe based on everything I've learned and experienced through my past actions as a Twitter co-founder and Lead:*

- *Social media must be resilient to corporate and government control.*
- *Only the original author may remove content they produce.*
- *Moderation is best implemented by algorithmic choice.*

*The biggest mistake I made was continuing to invest in building tools for us to manage the public conversation versus building tools for the people using Twitter to easily manage it for themselves this burdened the company with too much power and opened us to significant outside pressure such as advertising budgets. I generally think companies have become far too powerful. The only way I know of to truly live up to these three principles is a free and open protocol for social media that is not owned by a single company or group of companies and is resilient to corporate and government influence the problem today is that we have companies who own both the protocol and discovery of content which ultimately puts one person in charge of what's available and seen or not this is by definition a single point of failure no matter how great the person and over time will fracture the public conversation and may lead to more control by governments and corporations around the world.*

The following technologies were selected for this book long before Dorsey wrote those words, but they *are* the technologies in which he is investing his time and money to further those 3 principles.

### 5.3.1 Lightning

It is possible to log into a website using only Lighting, as in Stacker News.

### 5.3.2 Web5, Bluesky, & Microsoft ION

Promisingly Jack Dorsey's company TBD is working on a project called "Web5". Details are scant but the promise is decentralised and/or self hosted data and identity running on Bitcoin, without recourse to a new token. "*Components include decentralized identifiers (DIDs), decentralized web node (DWNs), self-sovereign identity service (SSIS) and a self-sovereign identity software development kit (ssi-sdk)*".

Web5 leverages the ION identity stack. All this looks to be exactly what our metaverse system requires, but the complexity is likely to be quite high as it is to be built on existing DID/SSI research which is pretty complex and perhaps has problems.

They readily admit they do not have a working solution at this time: "*At present, none of the DID methods meet our standards fully. Many existing DID networks are permissionless blockchains which achieve the above goals but with relatively poor latency (ION takes roughly 20 minutes for commitment finality). Therefore we have chosen to support did-web and a temporary method we've created called did-placeholder. We expect this situation to evolve as new solutions emerge.*"

#### 5.3.2.1 ION

While working at Microsoft on ION Daniel Buchner (now working at Square) or Henry Tsai said the following, which is worth quoting verbatim:

"While ledger-based consensus systems, on the surface, would seem to provide the same general features as one another, there are a few key differences that make some more suitable for critical applications, like the decentralized identifiers of human beings. Some of these considerations and features are:

- The system must be open and permissionless, not a cabal of authorities who can exclude and remove participants.
- The system must be well-tested, and proven secure against attack over a long enough duration to be confident in.
- The system must produce a singular, independently verifiable record that is as immutable as possible, so that reversing the record the system produces is infeasible.
- The system must be widely deployed, with nodes that span the

globe, to ensure the record is persisted.

- The system must be self-incentivized, so that nodes continue to operate, process, and secure the record over time. The value from operation must come from the system directly, because outside incentive reliance is itself a vector for attack.
- The cost to attack the system through any game theoretically available means must be high enough that it is infeasible to attempt, and even if an ultra-capitalized attacker did, it would require a weaponized mobilization of force and resources that would be obvious, with options for mitigation.

The outcome:

- Number 1 eliminates private and permissioned ledgers
- Number 2 eliminates just about all other ledgers and blockchains, simply because they are inadequately tested
- For the metrics detailed in 3-6, Bitcoin is so far beyond all other options, it isn't even close - Bitcoin is the most secure option by an absurdly large margin."

On the surface then it might seem that the choice is Bitcoin again, and indeed that the open source Microsoft ION stack is a natural choice, but it's complex to run, the interactions with the blockchain have a cost implication which can't be surmounted without every user owning some Bitcoin, and as we have seen, there is no formal validation of this system. In addition (in the current implementation) an identity proof does not need to be published to be valid, just timestamped. In this way an identity can be stolen and used years later to claim later chains of proof. It seems that it might be somewhat useful 'at scale' and is worth additional monitoring and investigation, especially given its integration into TBD - Web5.

### **5.3.3 Nostr**

Nostr is "The simplest open protocol that is able to create a censorship-resistant global "social" network once and for all." according to its github page. More than that it's a client side validated proof of who a user is interacting with, hence being in this identity section. To be clear, it's not a completely peer to peer system in that it uses relay servers, but this gives it some of the best characteristics of both paradigms. This has the following advantages for our metaverse application;

- it's lightweight, with minimal network overhead and complexity
- it's real-time using websockets
- anyone can run a relay server, so one can be run in the deployment in the final section of the book.

- Each of the client peers connecting to the metaverse can be a relay and able to pass messages and proofs to the other clients without the metaverse server seeing the data or being online
- it's opensource
- there are multiple usable libraries and tools
- it's under active development with an excellent team. The lead, 'Fiatjaf' is one of the most prolific developers in the lightning space.
- it's based on the same underlying cryptographic technology we are using elsewhere, indeed with its use of Bitcoin keys the identity system is global
- it provides the identity proof that we need to validate users and objects into a virtual space
- it enables message passing
- it scales to be a social network as required
- it need not rely on anything outside of a relay hosted on the metaverse server
- it can likely be scaled to provide one to many bulletin board style applications within the metaverse
- it can easily operate outside of the walled garden of the metaverse, extending the reach of the messages

Nostr is incredibly promising, and integrating these relays in the metaverse servers and clients of the proposed technology stack in this book might allow us globally provable identity, with privacy by design. It can provide message passing. If all entities in the metaverse scenegraphs are also Nostr key pairs then schema can be applied consistently with the economic layer using the same key system as Bitcoin. Nostr has just received a substantial grant from Dorsey. It is core to the design later in the book. A curated list of projects and libraries is available on [github](#).

#### 5.3.4 Slashtags

Slashtags is a new distributed identity open method being developed by Bitfinex and Tether under the Synonym suite. It uses Bitcoin keys for authentication, but communicates a schema through a metadata exchange.

This section needs a rebuild as they have landed a terrific ecosystems and we will certainly have to integrate some of it.

### **5.3.4.1 Anigma**

Anigma is a Nostr based clone of popular messenger client Telegram. This provides a web2 interface into the metaverse providing:

- simple cryptographic identity assurance
- private peer to peer chat
- group chats and channels
- email to private message relay
- links into media on web2 hosts

The proposed integration of Nostr, LnBit, Vircadia, and Bitcoin is the core value proposition of this book, with Anigma the final component.

## **5.4 Federated social media trust**

Keybase provides a model of importing proofs from various social media sites. This allows importing of reputation into new ecosystems.

## **5.5 Micropayment based web**

It seems the war against disinformation is now being lost. Much is written in the media about Deepfake technology creating plausible fake videos, but probably more pernicious is the use of toolkits to create entire plausible fake news sites using natural language AI such as GPT3. This makes it cheap to publish potentially market moving news which is then rehypothecated by online news vendors who are hungry for clicks. As these pipelines become more mature it will be difficult to keep fake news for financial or political gain out of the system. One interesting way to do this that *isn't* webs of trust or true cryptographic identity is to charge micropayments for “one to many” publication models. This would imply a tiny instant payment for clicks, especially on social media sites such as twitter. This kind of model has been discussed but is only possible in the context of systems such as Lightning where instant micropayment can be realised. It seems possible that this would price out speculative ‘noise’ spam from the information space. It’s interesting and ironic that the origin of proof of work was to underpin just such a spam defeating system [14], and that Nakamoto mentioned this application for Bitcoin back in 2009. There is now much chatter about the integration of Bitcoin with Twitter in light of Musks buyout of the social network. .

PRODUCT	BLOCKCHAIN	CRYPTOCURRENCY	PRODUCT OVERVIEW
<b>Arweave</b>	No	Arweave (AR)	Designed for data permanence, Arweave is a blockchain-like peer-to-peer storage protocol that is 100% community-operated. The permaweb, an immutable environment, is its application that enables data storage and other functionalities.
<b>BitTorrent</b>	Yes	BitTorrent Token (BTTR)	One of the oldest and most well-known decentralized data storage networks, BitTorrent has evolved into an entire suite of products, including the BitTorrent File System. The file system aims to reduce storage costs, improve fault tolerance and avoid government censorship. It is suitable for both file transfer and storage.
<b>Filecoin</b>	Yes	Filecoin (FIL)	Filecoin is a decentralized storage network that provides an open market for storing and retrieving files across an InterPlanetary File System connection. Users pay to store their files on storage miners, which can be any internet-connected computer or dedicated system with spare disk space.
<b>Safe Network</b>	No	Safecoin (MAID)	The Safe Network is built by MaidSafe to provide an autonomous and secure environment for storing and delivering data without human intervention. The network also provides a platform for decentralized websites, using the same cryptocurrency.
<b>Sia</b>	Yes	Siacoin (SC)	Sia is a peer-to-peer storage network that provides a marketplace in which renters form file contracts with hosts to create cryptographic service-level agreements that they store on the Sia blockchain. Sia distributes file segments to nodes across the globe to ensure redundancy and eliminate single points of failure.
<b>Storj/Tardigrade</b>	Yes	Storj (STORJ)	The Storj Network provides a decentralized storage infrastructure that enables node operators to deliver storage that can be consumed by Tardigrade customers. Storj offers a fixed pricing structure and is S3 compatible, with support for a wide range of use cases.
<b>Utopia</b>	Yes	Crypton (CRP) and Utopia USD (TOPIA)	The Utopia peer-to-peer network is billed as helping to reclaim online freedom and anonymity. Its secure communications prevent government and third-party surveillance. Users store data in encrypted containers.

SOURCE: ROBERT SHELDON AND BRENNAN POSEY

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Figure 5.2: Comparison of distributed file stores

## 5.6 Are DAOs useful for us?

A distributed autonomous organisation, or DAO is a governance structure which is built in distributed code on a blockchain smart contract system. Token holders have voting rights proportional to their holding. The first decentralised autonomous organisation was simply called “The DAO” and was launched on the Ethereum network in 2016 after raising around \$100M. It quickly succumbed to a hack and the money was drained. This event was an important moment in the development of Ethereum and resulted in a code fork which preserves two separate versions of the network to this day, though one is falling into obsolescence. Again, this is covered in Shin’s book on the period in extreme detail, but it seems this stuff is falling into dusty history now, leaving only a somewhat tarnished and technically shaky legacy [29].

In practice DAOs have very few committed ‘stakeholders’ and the same names seem to crop up across multiple projects. Some crucial community decisions within large projects only poll a couple of dozen eligible participants. Its might be that the experiment of distributed governance is failing at this stage.

Perhaps more interesting is the use of the DAO concept to crowd fund global projects, currently especially for the acquisition of important art or cultural items. DAOs are also emerging as a way to fund promising technology projects, though this is reminiscent of the 2017 ICO craze which ended badly and is likely to fall foul of regulations.

Within the NFT and digital art space PleaserDAO has quickly established a strong following. “PleasrDAO is a collective of DeFi leaders, early NFT collectors and digital artists who have built a formidable yet benevolent reputation for acquiring culturally significant pieces with a charitable twist.

Opensea wrangle between IPO and governance token.

ConstitutionDAO, Once upon a time in Shaolin etc

### 5.6.1 Bisq DAO

One of the better designed DAOs is Bisq DAO. It’s slightly different design tries to address the issue of overly rigid software intersecting with more intangible and fluid human governance needs. From their website:

*“Revenue distribution and decision-making cannot be decentralized with traditional organization structures—they require legal entities, jurisdictions, bank accounts, and more—all of which are central points of failure. The Bisq DAO replaces such legacy infrastructure with*

*cryptographic infrastructure to handle project decision-making and revenue distribution without such central points of failure.”*

## 5.6.2 Risks

The most interesting thing about DAOs is that they belong more in this money chapter than they do in blockchain. As we have seen they’re finding most success as loosely regulated crowd funding platforms. If a small company did find itself wishing to explore this fringe mechanism for raising capital, then we would certainly recommend keeping a global eye on evolving regulation and the onward legal exposure of the company.

## 5.7 Risks & Challenges?

Classic DID/SSI risks fragmentations. In all DID applications, scaling to a world where the user is managing potentially thousands of these critical cryptographic data files is daunting. Abstracting the guts of this away to make the use simple, and only mindful of the right level of information, turns out to be huge problem that nobody has solved. It’s not clear that users want this. In the case of web of trust like Slashtags it’s a big piece of work for the users to rate all of their digital interactions with a trust metric.





## 6. Digital Objects & NFTs

Nonfungible tokens are a whole ‘class’ of digital token, separate and distinct from everything discussed to this point. They are generally recognised in law as property in their own right [115, 116]. In the Initial Coin Offering (ICO) and project tokens detailed earlier, and limiting this description to the Ethereum network for now, a project launching an ERC-20 token commits contract code to the blockchain, and this contract then mediates the issuance and management of millions or billions of tokens associated with that project, and it’s use case. ERC-20 is a fungible token issuance. Each of the projects’ tokens is interchangeable with any other token. They’re all the same from the point of view of the user.

Rather than the ERC-20 contract type used for fungible token issuance NTFs predominantly use ERC-721 protocol on Ethereum (just different instructions). It’s the case that most NFTs in the 2021/2 hype bubble are algorithmically generated sets of themed art (so called PFP-NFT). Tens of thousands of distinct tokens are ‘minted’, each one being a complex transaction commitment to the Ethereum blockchain, along with it’s associated gas fee. These minting events were much hyped social occasions (before the 2022 market crash), and happened very quickly, with users clamouring to create art with randomly allocated features from the art schema associated with the project. Lucky winners could find themselves with an NFT art piece with more than an average

number of ‘rare’ features. If the overall mint becomes more popular, then the secondary market for all of those mints goes up, and because of the liquidity premium they can go up a lot. The perceived rarer mints go up a lot more. This whole process is very energy intensive on the chain, and the vast majority of these project simply trend to zero value. In response to this appalling cost benefit analysis the Ethereum foundation have proposed [EIP-2309](#) to make minting NFTs more efficient. They say “This standard lets you mint as many as you like in one transaction!”

The Ethereum foundation give their somewhat constrained view of NFTs on their website and it’s a useful primer. On that page they detail some of the use cases, as listed below, with a critique added:

- Digital content; this is the dominant use case right now. Much more on this later.
- Gaming items; again more on this later, it’s an obvious enough use case but complex politics in the intersection of games and crypto have stalled the adoption curve.
- Domain names; this is just starting to reach for applications now, why not a database with the ISP/host?
- Physical items; seemed like a clear over-reach as transfer of the NFT does not imply transfer of the object, but this is emerging as the growth use case.
- Investments and collateral; while this was an emergent option in the space, it’s likely been a bubble, as owners of the tokens cast around for additional liquidity, and loan businesses chased yield with higher risk. The recent implosion of lenders and funds in the crypto space was partly a function of supposedly world class risk managers accepting jpegs as collateral.

Moving away from Ethereum, NFTs can be minted on most of the other level one chains. Solana is a great newcomer example. Sol is a terrible chain with regards to decentralisation, but thanks to that it’s far cheaper and faster to mint NFTs on it, and it was becoming a troubling competitor for Eth before the FTX ponzi scheme collapse destroyed its market value (Figure 6.1).

The same might be true for Cardano’s ADA, though ADA is struggling to hold onto its market position despite some technical advances. It’s worth reiterating here that the nature of these digital tools likely makes for a ‘winner take all’ market dynamic over time. With fees being central to this generative NFT use case it’s possible to see that highly centralised, fast, and cheap chains will capture and eventually dominate the space. Remember that this likely (game theoretic)

### Magic Eden statistics

This data represents the raw on-chain activity of the tracked smart contracts



### OpenSea statistics

This data represents the raw on-chain activity of the tracked smart contracts

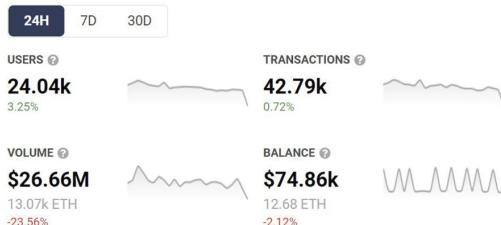


Figure 6.1: Solana NFT markets are enjoying growth compared to Opensea on Ethereum, even in the downturn.

outcome might as well be a database running without the stark inefficiencies of blockchain. The whole NFT space is a gamble on consumer enthusiasm for spending money continuing to outpace logic.

Astonishingly, according to a JPMorgan insider market report (reported on in a podcast), only around 2 million people have ever actually interacted with NFTs. One analysis suggests that a single entity accounts for 3 of the top 4 holders, having made 32,000 ETH from the NFT boom. This suggests heavy market manipulation and is far from the egalitarian landscape claimed in the hype. Tellingly it's thought around 10% of the trading volume on market leading platform 'Super Rare' was by the now bankrupt venture capital firm 'Three Arrows'.

With that said NFTs have clearly allowed digital and new media artists to connect with audiences without gatekeepers. Established mediators and curators of art have been caught totally wrongfooted, and NFTs seem to give a way for them to be cut out completely. There are suggestions of applications beyond this initial digital art scope. This is a compounding, and disrupting paradigm change.

## 6.1 Key use cases

### 6.1.1 Art

The recent surge of interest in NFT's during early 2021 has largely been driven by digital art NFT's, despite the origins of digital art NFT's started much earlier in 2014. New York artist Kevin McCoy's *Quantum* is widely recognised as the first piece of art created as an NFT. However it was during early 2021 that art NFT's started to gain significant attention; by the end of 2021, nearly £31b had been spent on NFT purchases, a considerable and exponential growth given 2020 sales of ~£71m High profile digital artists such as *Beeple* whose recent recording break sale of his NFT "*The first 5000 days*" (Figure 6.2) at Christies (a long established British auction house, specialising in high profile precious work of art) for £52.9m helped bring NFT's into the public spotlight and wider give them global attention.

Art as NFT's offer the following advantages:

#### 6.1.1.1 Immutable Nominal Authenticity

Art fraud such as false representation, forgeries, plagiarism have been a reoccurring blight since art has existed; artists and works of art have been open to abuse by forgers, black market profiteers and even fellow artists laying claim to works of art of others. Unless a work of art is sold, exhibited or listed, documenting when and who created it, the *nominal authenticity*, which Dutton states as the "*correct identification of the origins, authorship, or provenance of an object*" [117] can be increasingly mutable over a period of time, dependent on a multitude of factors, including; the artists existing profile, how widely and where the work of art is exhibited, if the work of art is commissioned by a patron, if it's sold, and profile of the buyer/collector. At its most basic level, once a work of art is 'minted' as an NFT (publishing the art work as a unique token on the blockchain) this functions as an immutable publicly accessible proof of ownership and by extension proof of creation. The act of minting is not purely limited to digital art; all an artist requires is a digital representation of any physical art (sculpture, physical painting, installation etc..) which can be used as a proxy allowing artists to record the date of creation/origin of a physical piece of art on the blockchain, a buyer purchasing the NFT can be provided the actual physical artwork as part of the NFT. Nominal authenticity becomes secure and immutable for the lifetime of the blockchain (by no means assured).

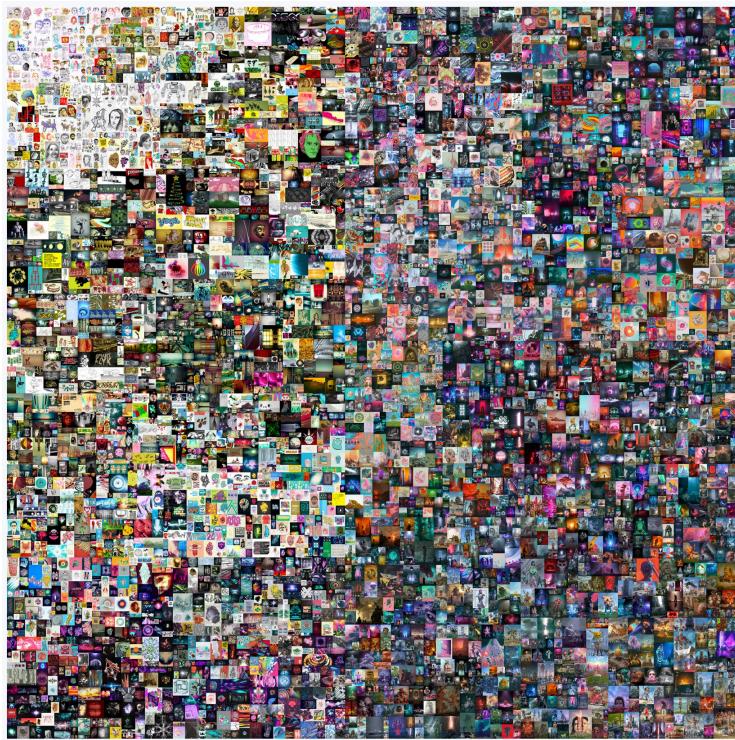


Figure 6.2: Beeple: First 5000 days, taken from the Christies website, assumed fair use.

### 6.1.1.2 Secure Digital Provenance

Provenance (or the chain of custody) is an important aspect in works of art, antiques and antiquities. Provenance not only helps assign work to an artist but also documents ownership history. Digital provenance, an inherent feature of NFT's means provenance now no longer becomes what has historically sometime been a contentious detective's game at the best of times; one that is open to fraud, misinterpretation and entirely reliant on good record keeping.

Since provenance can contribute to the value of a piece of art (benefiting both the creator and collector) the use of the blockchain as an open, secure ledger is a far more trustworthy system than traditional methods of artistic provenance that were cobbled together; often consisting of a mix of physical and digital documents spanning private &

public sale receipts, art/museum gallery exhibitions and private record keeping). Digital provenance provided when an artist ‘mints’ a piece of art into an NFT allows artists and collectors to record a secure, permanent unalterable history of transactions for a specific piece of art, providing future collector complete trust in the origin and custody of a piece of art.

#### **6.1.1.3 Decentralised automated royalty payments**

Traditionally if a piece of art is sold, the first sale may (but not always) benefit the artist financially, however secondary and any subsequent sales would only ever financially benefit the buyer/collector; the original artist would rarely benefit. However If a work of art is minted into an NFT, royalty payments can be predetermined and automated in perpetuity directly by the use of a ‘smart contract’. Smart contracts are small, automated scripts/programs that run automatically and independently of a buyer/seller; pre-determined conditions are set by the buyer; these trigger when certain conditions are met i.e. These cannot yet be enforced “on chain” and the NFT auction houses online have engaged in a race to the bottom and stopped enforcing royalty payments through their systems. This element might not even be possible, though there is some hope that we could enable this in the complex logic offered by the RGB protocol.

#### **6.1.1.4 On sale transfer**

20% of total sale amount into digital wallet of the creator. 80% of total sale amount into digital wallet of the seller.

Once the royalty payment rate is set by the artist/creator, future royalties of all sales can be paid directly to the artist/creator account (via a digital wallet) without the need of a third party (traditionally a gallery/agent etc..).

Smart contract driven NFT’s means that even if piece of art is resold 5, 10 or even a 100,000 times moving through 5, 10 or even a 100,000 different collectors; a pre-determined royalty payment rate set by the creator would still guarantee the artist/creator is paid directly from each and every future sale.

Historically provenance for works of art may span across generations, for instance Gabriël Metsu’s oil on canvas painting *The Lace Maker’s* provenance, first recorded in 1722, now spans 300 years of ownership, including from a British Baron in the 19<sup>th</sup> century to an American philanthropist in the 20<sup>th</sup> century.) Metsu died young at the age of 38, leaving a widow; neither his/her relatives/descendants benefit

from his original work, 300 years later this would be near impossible to facilitate with traditional systems, as even legal contracts are open and prone to the ravages of time.

NFT smart contracts hold an incredibly potential; an artists descendants financially benefiting directly from the resale of a piece of work long after the artist/museum's/gallery or even state have turned to dust as long as the original creator's digital wallet is accessible, *the blockchain becomes an everlasting digital patron* ensuring

NFT art currently suffers from the same failure of decentralisation already discussed in the Ethererum technology stack, but this is compounded by the normalisation of intermediate art brokers continuing to custody the NFTs even after sale. They are usually selling a pointer to their own servers. The market is nascent and evolving, but it's currently not delivering on it's core promise.

Proof of ownership is intuitively a pretty obvious application for the technology, but again it's hard to justify the expense when the benefits are so slim. Bulldogs on the blockchain is a clear gimmick, and might even incentivise poor behaviours as there are two products here which are not necessarily aligned. Much has been written over the years about deeds to property being passed through blockchains, cutting out the middle man, but in the event that a house deed NFT was hacked and stolen it's obviously not the case that the property would then pass to the hacker.

One of the most interesting companies is Yuga Labs, who launched the incredibly popular Bored Ape Yacht club set of 10,000 algorithmically generated NFTs. These Ethereum based NFTs were based loosely on the 'Crypto Punks' model of PFP-NFT (variously profile picture project, picture for proof, and picture for profile - no definition remains uncontested for long). Yuga launched with a better commercialisation model for the holders, and a strong marketing drive into celebrity circles. They now regularly change hands for hundreds of thousands of pounds. Even this 'blue chip' NFT is not without serious criticism: "*I'd put it at 99.99% the project is in fact a deliberate troll, intentionally replete with Nazi symbols and esoteric racist dog whistles*"

Yuga recently bought the artistic rights to the commercial reuse of similarly popular (and preceding) Punks set. This is interesting because they have again handed the commercial re-use rights to the owners of the individual NFTs. This raises the same confusing problem with attaching commercial rights to an easily stolen token as NFTs for real estate does. This has been demonstrated recently when Seth Green had a Bored Ape stolen after creating an animated show around it's IP. Many

more contradictions and ambiguities in NFT licenses are emerging. Galaxy Digital have surveyed the landscape: “*Contrary to the ethos of Web3, NFTs today convey exactly zero ownership rights for the underlying artwork to their token holders. Instead, the arrangements between NFT issuers and token holders resemble a distinctly Web2 maze of opaque, misleading, complex, and restrictive licensing agreements, and popular secondary markets like OpenSea provide no material disclosures regarding these arrangements to purchasers. Something more is required, and that ‘something’ is a legal agreement between the owner of the image—known as the ‘copyright holder’ and the NFT holder specifying what rights the NFT holder has with respect to the image. To the extent an NFT purchaser has any rights to the image associated with his or her NFT at all, those rights flow not from his or her ownership of the token, but from the terms and conditions contained in the license issued by the NFT Project governing the NFT holder’s purchase and use of the image. Accordingly, for the vast majority of NFT projects, owning the NFT does not mean you own the corresponding digital content that is displayed when you sync your wallet to OpenSea. That content, as it turns out, is owned and retained by the owner of the copyright associated with that digital content, typically the NFT project. After reviewing the most used license agreements for NFT projects, it becomes apparent that NFT standards and smart contracts do not recognize off-chain law.*” There may already be a response from the industry to this in the shape of a16z’s “can’t be evil” license proposal.

Even so, the community around these collections is incredibly strong, mixing developers, artists, the rich and famous, and the fortunate and early, into a cohesive community who communicate online. The developer ‘good will’ is enormous, and it seems possible that this will lead to faster and broader innovation around the collections, and out into metaverse applications. The brand is strong, and the individual NFT items both benefit from, and reinforce that brand, while adding personal narratives and human interest.

As a gauge of how frothy this market still is it’s interesting to look at the APE token which Yuga just launched. They airdropped 10,000 of the tokens free to each of the 10,000 NFT holders. This instantly created a multi-billion dollar market cap, and a top 50 ‘crypto’ out of thin air, based purely on their brand. It’s clear that there is both brand, and a market here.

A recent report from "Base Layer" tries to capture the community ‘feature’ of big brand NFTs. “Crypto culture decoded” explains that is

is these online communities which are the attraction not necessarily the art. This is a powerful ‘in group’ argument, though speculation remains the most likely underpinning.

While it is likely that this is currently a speculative bubble, that is waning already (Figure 6.3), it seems certain that the technology is here to stay in some form.

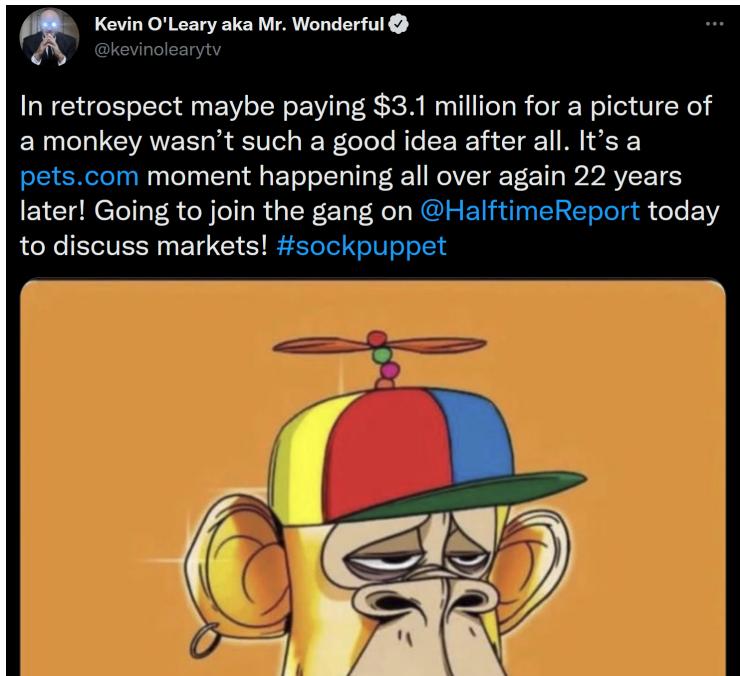


Figure 6.3: The bubble bursts on Yuga Bored Apes for now.

## 6.1.2 Computer & Video Games

Computer & Video games are a huge global business, exponential global growth over the last 30 years has seen this grow to a point where it has eclipsed both the global movie and North American sports industries combined.

A global industry with revenues over £120b, with ~half the people on the planet playing some form of games in 2021.

As the games industry has evolved and matured over the last 40 years, secondary markets have emerged, most notably the ‘second hand’

games resale market. The rise of ‘retro’ gaming, has demonstrated the second hand market is a lucrative one for private resellers, an unopened copy of Super Mario Bros for the Nintendo Entertainment System recently selling for £1.5M to the extent the market has seen speculators looking to cash in on the huge global interest in retro/second hand games.

Despite publishers and developers increasingly moving to non-physical digital only’ games, the demand for used games remains incredibly high.

Whilst some retailers have adapted their business models to include reselling of retro/second hand games, the vast majority of publisher/developers/retailers aren’t able to directly benefit from the emerging retro/second hand games market. The potential of *video games as NFT’s* presents a huge opportunity for publishers, developers and players alike, offering the following advantages:

#### **6.1.2.1 Royalty Sales on Pre-owned Games**

; A predetermined proportion of any resale of a used game can automated in perpetuity via smart contracts; once these are set by the publisher, future royalties of all sales can be paid directly to the publishers/developers wallets (a digital account) without the need of a third party (traditionally a retail entity). Traditionally only the initial first sale of a game would financially benefit the publisher/developer/retailer, secondary and subsequent sales would only ever financially benefit the purchaser, with many developers/publishers arguing this is hurting the wider industry through the loss of significant income generated by the secondary and subsequent sales, sometimes over the course of decades. However the use of NFT’s smart contracts means that if a game is sold/resold through 10,000 collectors; a pre-determined royalty payment rate set by the publisher would still guarantee the publisher (and or developer/retailer) takes a proportion of any future sales.

#### **6.1.2.2 Monetisation of User Generated Content:**

Games as a NFT’s offer ability to monetise UGC: User generated content. Video games such as Nintendo’s *Pokemon Go* (166 million players), Bungie’s *Destiny 2* (38 million players) or miHoYo’s *Genshin Impact* (9 million players ) all have large, established and significant player bases. What is noteworthy, the games are designed to encourage players may spend hundreds, or in some cases thousands of hours on one game alone; according to [Destinytracker.com](https://www.destinytracker.com), the top players have amassed total play times over 20,000 hours, close to 1,000 days or ~ 3

years, which is incredible feat given Destiny 2 only launched 5 years ago in 2017.

Destiny/Pokemon Go and Genshin Impact revolve around a central key game mechanic; players investing significant amounts of time collecting in game digital assets; characters/weapons/items, often classed as ‘rare’ or ‘exotic’ or ‘5 Star’. These collectibles usually found by a combination of the accrual of in-game time, completing quests, purchasing additional in-game items/boosters, and luck (‘RNG’). Players are often encouraged to share their collections of rare characters/weapons/objects through in-game achievements, triumphs, scores acting as a mark of distinction/status symbol.

Traditionally there has been nothing that went beyond sharing the *digital badge* (i.e triumph/achievement/accomplishment) on a social media/gamer’s platform profile. However NFT’s offer the ideal system for developers/publishers and even players to monetise user generated/customised data (such as a players unique save game data), simultaneously allowing: a) creation of an additional monetised ecosystem to meet player demands i.e. some players who are willing to monetise and ‘sell’ their invested time in a particular product/service to other players with little time but willing to pay other players for ‘grinding’ (progressing laborious in game tasks) and a more advanced in-game progression point. The potential to provide publishers/developers with an additional long-term income stream, providing a better ROI on computer & video game development, which in many instances can cost hundreds of millions in development costs spanning 5/10 years, is undeniable.

### **6.1.2.3 Play to earn revenue models**

This is morally dicey at this time and early startups like Axie Infinity are in serious trouble. A (long) video by Dan Olsen highlights the structural problems with both play to earn and NFTs. On chain analysis suggested that 40% of accounts in 200 current Web3 games are bots.

### **6.1.2.4 Monetizing In game collectibles**

customisable in game assets (vanity items such as cosmetic character skins/clothing or collectible items that offer player advantages(new weapons/vehicles/mods etc,..)

Traditional gamers have pushed back on the seemingly useful idea of integrating NTFs with traditional games. This may be in part because Ethereum mining has kept graphics card prices high for a decade.

HBAR partnerships

Critique from Marc Petit of Epic and Unreal.

The following text is from Justin Kan, co-founder of twitch: “*NFTs are a better business model for games. Many gamers seem to be raging hard against game studios selling NFTs. But NFTs are also better for players. Here’s why I think blockchain games will be the predominant business model in gaming in ten years. NFTs are a better business model for funding games . Example: recently I invested in a new web3 game SynCityHQ. They are building a mafia metaverse and raised \$3M in their initial NFT drop.*

*NFTs give studios access to a new capital market for raising capital from the crowd.NFTs can be a better ongoing model for games. Web3 games will open economies, and by building the games on open and programmable assets (tokens + NFTs) they will create far more economic value than they could from any one game. Imagine Fortnite, but other developers can build experiences on top of the V-Bucks and skins. Epic would get a royalty every time any transaction happens. As big as Fortnite is today, Open Fortnite could be much bigger, because it will be a true platform. NFTs are better for gamers Allowing gamers to have ownership of the assets they buy and earn in game allows them to participate in the potential growth of a game. It lets gamers preserve some economic value when they switch to playing something new. But what about the criticisms of NFTs?*

*Here are my thoughts on the common FUDs: "It's just a money grab on the part of the studios!"*

*Game studios already switched over to the model of selling in-game items, cosmetics, etc to players long ago. But currently the digital stuff players are buying isn't re-sellable. NFT ownership is strictly better for players. "The games aren't real games." This reminds me of the criticism of free-to-play in 2008, when the games were Mafia Wars / FarmVille. We haven't had time for great developers to create incredible experiences yet. Everyone investing in games knows there are great teams building. "Game NFTs aren't really decentralized because they rely on models / assets inside centralized game clients." Crypto is as much a movement as it is a technology. Putting items on a blockchain is what gives people trust that they have participatory ownership...which make people willing to buy in to the game. These assets are “backed” by blockchain. The fact that these item collections are NFTs will make other people willing to build on top of them. "NFTs are bad for the environment." Solana and L2s solve this. NFT games are better for players and for game developers. Like the free-to-play revolution changed gaming, so will blockchain. The games of the future*

*will be fully robust, with open and programmable economies.”*

## 6.2 Broader and metaverse uses

So far according to a16z NFTs break down into:

- Profile pictures: These were discussed at the start of the chapter and have felt ubiquitous on Twitter over the last couple of years. The major projects will likely hold value, but the hype cycle will likely lead to all profile NFTs going in and out of fashion. There's potentially a fresh wave of this same kind of low key identity hype possible in the metaverse, and indeed the two plausible both intersect and converge.
- Art and Music: Art has also been discussed above. Peter Thiel, the billionaire venture capitalist who founded PayPal has invested in expanded NFT use cases. The first is 'Royal' which is experimentally selling limited NFT tokens which contractually entitle the holder to a portion of music artist royalties. Spotify are experimenting with music NFTs (and of course in the metaverse). This is an early adopter area, and again likely converges with our planned uses cases as more complex tooling appears. For instance Tim Exile of Endless.fm talks about digital assets extending to the building blocks of co-created music, and wished to build a music creator economy which distributes value to creators at the instant of the final value transaction with the consumer.
- Gaming: As discussed there's pushback from the gaming community, but huge investment from the likes of Lego, Blizzard, Epic, Ubisoft etc.
- Gig tickets: Not only the straightforward use of transferable tickets for events as NFTs on a blockchain (which is impossible due to the cost right now) but also onward monetisation of ticket stubs as memorabilia. The NBA is already looking at this.

*“The team sells the ticket for face value many many years ago, but when that stub is being sold now for much more many times over, the team gets none of that money,” York explained. “But with an NFT stub that changes. Let’s say a new rookie enters the NBA next season and he turns out to be the next LeBron James. That ticket stub from his first game, as an NFT, the team can put a commission on it — 20 percent or however much, the NBA decides that. In 10 years when it’s worth a lot of money, I or whoever owns that NFT, can sell it for say \$100,000. The NBA can still collect 20 percent of that sale, because it’s all on a smart*

*contract.”*

It seems so obvious that this will extend to the virtual events space in the metaverse.

- Utility: These are broadly ‘membership’ style tokens, and this seems like a sensible fit. Peter Thiel (again) for instance launches a political funding NFT from Blake Masters to support his senate ambitions. To be clear, Thiel is a fundamentalist libertarian, and at the very least highly eccentric. This is not necessarily a positive for the technology.
- Virtual worlds are a huge application for NFTs, and this seems like it would be a natural fit for our metaverse application. In reality the \$2B of sold so far is mostly ‘allocations’ in nascent ecosystems, being sold as highly speculative assets, without even a metaverse to use. The majority of that amount is the hyped ‘Otherland’ plots sold under the Bored Apes brand.
- “Full stack” luxury brands. Nic Carter describes a mating of physical and virtual luxury goods. His is a useful article on the future direction, and he has also provided a primer on NFTs. There are many such examples already, such as Tiffanys ‘NFTiff’ - cryptopunks collaboration which will automatically generate royalties for Tiffanys and parent company Louis Vitton in perpetuity. Such products prove provenance, create new aftermarket opportunities, and unlock metaverse applications.

It is completely reasonable to assert that these use cases could be accomplished without the use of NFT technology, and is part of the hype bubble.

Twitter user Cantino.Eth offers an exhaustive roundup of what they think future uses might be. It’s a thread full of industry insider jargon but it’s indicative of a shift in focus from speculation to ‘building’ as the market conditions change. Some of the more interesting (less arcane) use cases identified in the thread are summarised very briefly below, again with comments as to how this might pertain to our metaverse applications.

- Hobby tokens, demonstrating interest in an activity. This is potentially a metaverse adaptation of badges on a blazer in the real world, and might serve to drive communities in a metaverse. The same is true for activism and political alignment. It’s a great idea and worth developing.
- Professional Networks and qualification badges, like a LinkedIn qualification panel, but in the metaverse. A Cisco NFT in the metaverse for a CCNA qualification makes intuitive sense.

- Badges to indicate membership of distributed projects within a metaverse. This allows users to identify avatars with shared goals in the metaverse.
- Retail incentives, like brand loyalty stamps or rewards for participation in marketing, or early access programmes. This is a true in a metaverse marketplace as it is in a real world coffee shop.
- Multiplayer communities with incentives to hit collective milestones. “Collecting as a team sport”. This again seems like a great and intuitive opportunity, but is perhaps less suitable for our more business focussed space. User content submission and automatic monetisation when reused by brands, bonded to an NFT contract.
- Customer Cohort NFTs: early adopters of successful brands would be able to prove the provenance of their enthusiasm for a new product, and this might unlock brand loyalty bonuses. It seems this wouldn’t be a transferable NFT, and is more like the “soulbound” idea advanced by Meta.
- Education and Customer Support, think an NFT of a great score on reddit community support forums. A trusted community member badge, but visible in the metaverse. This is somewhat like the web of trust model advanced earlier in the book.
- NFTs as contracts is far more likely in the metaverse than it has proved to be in real life. This is how ‘digital land’ and objects will be transferred anyway, but with the addition of contractual conditionals with external inputs more subtle products may appear.

### 6.3 Objects in our metaverse

There has been a recent shift away from the ‘toxic’ moniker of NFT and toward ‘Digital objects’, and seem to be judged crucial to metaverse applications. The success of avatar ‘collectibles’ markets in the Reddit ecosystem, and Meta (ex Facebook) similarly divesting themselves of the NFT term seem to suggest a pivot point in the industry. Meta are encouraging adoption through zero fee incentives but are likely hanging their monetisation of their whole rebrand on taking a huge cut from NFT content creators on their platform. Crucially for the whole concept of NFTs in crypto it looks like they will custody the digital objects within their databases, and allow them to be both bought and sold through interactions with ‘normal’ Fiat money. This completely breaks the model of what an NFT represents, and may in time dilute

the technology to the point of being completely meaningless.

We have a path to assets and NFTs within the layer 3 elements of our choice (RGB & Peer Credits), but they're not yet fit for purpose. There are compromise options already available, as below.

### **6.3.1 Liquid tokens**

We have seen that Liquid from Blockstream is a comparatively mature and battle tested sidechain framework, based upon Bitcoin. It is possible to issue tokens on Liquid, and these have their own hardware wallet available. This makes the technology a strong contender for our uses.

### **6.3.2 Sovryn and RSK**

It's slightly unclear when RSK will support assets at this level. This needs to be revisited.

### **6.3.3 Stacks and STX**

There's another possible option is Stacks, without the network effect of Ethereum, but closer to the other design choices made so far. "Stacks is an open-source network of decentralized apps and smart contracts built on Bitcoin."

This novel approach saw the launch of a layer 1 blockchain token called STX, which is used in a similar way to gas in Ethereum. but claims settlement on the Bitcoin network. This is achieved through a novel bridging approach which they call Proof of Transfer (PoX).

Stacks users say this hybrid approach is a pragmatic solution which enables dApps, smart contracts, DeFi, NFTs etc without compromising security. In practice the speculative component of the STX tokens which underpin these operations clouds the issue somewhat. It is a potentially useful middle ground solution with a great deal of developer attention.

### **6.3.4 Ethereum**

While it's been discounted elsewhere it's hard to ignore the network effect of Eth NFTs. If the aspiration is to attract the bulk of the 'legacy' creator/consumer markets then it will be necessary to support integration of Metamask into any FOSS stack. This isn't a huge technical challenge, nor is it particularly of interest to our use cases at this stage, but it remains a possibility. The main problems remain the slow speed and high expense of the system.

### 6.3.5 Solana

Solana is both cheap and fast, because it's very highly centralised. It seems unlikely that it's worth this level of compromise. It has also become embroiled with the fallout from the enormous FTX exchange fraud, threatening the existence of the assets (NFTs) issued and stored upon it.

### 6.3.6 Satoshi Ordinals

Satoshi ordinals allow tracking of Sats across transactions, enabling NFT like assignment tracking. This is a hugely exciting development but extremely early.

### 6.3.7 Peerswap

It may be possible to use “Peerswap” to execute rebalancing and submarine swaps into and out of Liquid assets on the sidechain in a single tx. This is an under explored area at this time.

### 6.3.8 FROST on Bitcoin

It **might** be possible to transfer ownership of a UTXO on the Bitcoin base chain using FROST [118]. In this Schnorr & Taproot based threshold signature system it's possible to add and remove signatories and thresholds of signing without touching the UTXO itself. In principle (though not yet in practice) this might allow transfer of UTXO ownership.

### 6.3.9 Spacechains

It feels like spacechains are almost ready, so this is worth keeping an eye on. It's the ‘cleanest’ way to issue assets using Bitcoin because there's no additional speculative chain. As briefly explained in the earlier section Bitcoin is destroyed to create a new chain which then inherits the security of Bitcoin through onward mining. This new asset or chain is able to accrue value and trade independently based purely on its value to the buyer, not as a function of a wider speculative bubble attached to a token with multiple use cases.

### 6.3.10 Pear credit

The outstanding contender at this stage is Pear Credit from Hypercore. This section needs a full explanation later. For now a blog post on the

subject will have to do.



## 7. Metaverses

### 7.1 Toward an open metaverse

The Openstand principles are a great starting place for what an open metaverse might mean. They are:

- Cooperation: Respectful cooperation between standards organizations, whereby each respects the autonomy, integrity, processes, and intellectual property rules of the others.
- Adherence to Principles: Adherence to the five fundamental principles of standards development:
  - Due process. Decisions are made with equity and fairness among participants. No one party dominates or guides standards development. Standards processes are transparent and opportunities exist to appeal decisions. Processes for periodic standards review and updating are well defined.
  - Broad consensus. Processes allow for all views to be considered and addressed, such that agreement can be found across a range of interests.
  - Transparency. Standards organizations provide advance public notice of proposed standards development activities, the scope of work to be undertaken, and conditions for participation. Easily accessible records of decisions and

the materials used in reaching those decisions are provided. Public comment periods are provided before final standards approval and adoption.

- Balance. Standards activities are not exclusively dominated by any particular person, company or interest group.
- Openness. Standards processes are open to all interested and informed parties.
- Collective Empowerment: Commitment by affirming standards organizations and their participants to collective empowerment by striving for standards that:
  - are chosen and defined based on technical merit, as judged by the contributed expertise of each participant;
  - provide global interoperability, scalability, stability, and resiliency;
  - enable global competition;
  - serve as building blocks for further innovation;
  - contribute to the creation of global communities, benefiting humanity.
- Availability: Standards specifications are made accessible to all for implementation and deployment. Affirming standards organizations have defined procedures to develop specifications that can be implemented under fair terms. Given market diversity, fair terms may vary from royalty-free to fair, reasonable, and non-discriminatory terms (FRAND).
- Voluntary Adoption: Standards are voluntarily adopted and success is determined by the market.

Hopefully it's clear to the reader that this kind of development guides the work here. In the wider “real-time social VR” various companies have attempted to build closed ecosystems, for years. These now look more like attempts at digital society, but are closer to isolated metaverses, or more usefully isolated digital ecosystems. This is still happening. There's every chance that when Apple make their augmented reality play this year or next they will keep their system closed off as this tends to be their business model. Theo Priestly, CEO at Metanomics points out that Chinese Giant Tencent are doing similar, and he cited Figure 7.1; building a closed but tightly linked suite of businesses into something that looks like a metaverse. The levels of investment which are being hung under the metaverse moniker are mind blowing, but that is not what we want to discuss as an end point for this book. For our purposes in this product design the interface between the previous chapter (NFTs) and this metaverse chapter is crucial. Punk6529 is a

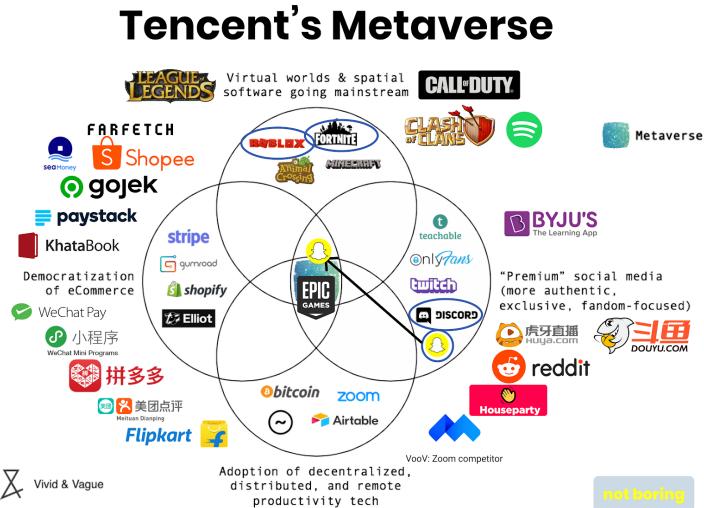


Figure 7.1: McCormick attempts to guess the Tencent metaverse

pseudonymous twitter account and thought leader in the “crypto” space. The text below encapsulates much of the reasoning that led to this book and product exploration, and is paraphrased from this thread for our purposes.

*Bit by bit, the visualization layer of the internet will get better until it is unrecognisably better (+/- 10 years). As the visualization layer of the internet gets better, digital objects will become more useful and more important. Avatars (2D and 3D), art, schoolwork, work work, 3D virtual spaces and hundreds of other things. Not only will the objects themselves become more important, they will lead to different emergent behaviours. We see this already with avatars and mixed eponymous/pseudonymous/anonymous communities. Yes, it is the internet plumbing underneath, but just like social media changed human behaviour on the internet, metaverse type experiences will further change it. NFT Twitter + Discord + various virtual worlds is a form of early metaverse. I feel like I am entering a different world here, not just some websites. The most important question for the health of the internet/metaverse/human society in the 2030s will be decided now. And that question is: "who stores the definitive ownership records of those digital objects". There are two answers: a company's database OR a blockchain. If we end up with "a company's database" we will end*

*up with all the web2 dysfunctions, but worse. SMTP is an open protocol that anyone can use so we don't have societal level fights on "who is allowed to use email". Short messaging online ended up becoming Twitter. So we end up having the most absurd, surreal discussions on the topic of "who is allowed to use short-messaging" being dependant on "who is the CEO of Twitter". There is no way this is the correct architecture for our progressively more digital economy.... If this is your first time around here, we are fighting for an open metaverse."*

It seems that industry shares much of this opinion regarding an open metaverse. The proposal of a persistent interactive digital universe online is **so** vast that major players recognise that they will not be able to monopolise this space, though Facebook/Meta are clearly attempting to. The Metaverse Standards Forum is clearly an attempt by the other industry players to catch up and then get out ahead of Meta in this regard. It's also possible to view this as just another land grab, but through the vehicle of a standards body. Time will tell. They say:

*"Announced today, The Metaverse Standards Forum brings together leading standards organizations and companies for industry-wide cooperation on interoperability standards needed to build the open metaverse. The Forum will explore where the lack of interoperability is holding back metaverse deployment and how the work of Standards Developing Organizations (SDOs) defining and evolving needed standards may be coordinated and accelerated. Open to any organization at no cost, the Forum will focus on pragmatic, action-based projects such as implementation prototyping, hackathons, plugfests, and open-source tooling to accelerate the testing and adoption of metaverse standards, while also developing consistent terminology and deployment guidelines."*

This looks like it will be a useful project and community for the purposes outlined in this book, but the technology is young enough (in that it doesn't really exist) for multiple approaches to be trailed.

Europe is making metaverse a priority with The Virtual and Augmented Reality Industrial Coalition. President von der Leyen's State of the Union letter of intent says: "We will continue looking at new digital opportunities and trends, such as the metaverse."

### 7.1.1 Primitives

OpenAI identified the following 5 points about metaverse, in response to the query "What are 5 key points I should know when studying metaverse?"

- Metaverse is a virtual reality platform that allows users to interact

with each other and with digital objects in a virtual space.

- Metaverse is a decentralized platform, meaning that there is no central authority or server that controls the platform.
- Metaverse is an open platform, meaning that anyone can develop applications for the platform.
- Metaverse is a secure platform, meaning that all data and transactions are encrypted and secure.
- Metaverse is a scalable platform, meaning that it can support a large number of users and a large number of transactions.

This is an unexpectedly great answer, probably the cleanest we have found. The [Metaverse Standard Forum](#) highlights the following, which reads like the output from a brainstorm between academia and industry stakeholders.

- collaborative spatial computing
- interactive 3D graphics
- augmented and virtual reality
- photorealistic content authoring
- geospatial systems
- end-user content tooling
- digital twins
- real-time collaboration
- physical simulation
- online economies
- multi-user gaming
- new levels of scale and immersiveness.

It's not a useless list by any means, but it lacks the kind of product focus we need for detailed exploration of value and trust transfer.

Mystakidis identifies the following [119]:

- Principles
  - Interoperable
  - Open
  - Hardware agnostic
  - Network
- Technologies
  - Virtual reality
  - Augmented reality
  - Mixed reality
- Affordances
  - Immersive
  - Embodiment
  - Presence

- Identity construction
- Challenges
  - Physical well-being
  - Psychology
  - Ethics
  - Privacy

This is quite an academic list. A lot of these words will be explored in the next section which is more of an academic literature review.

Nevelsteen attempted to identify key elements for a ‘virtual work’ in 2018 and these are relevant now, and described rigorously in the appendix of his paper [120]:

- Shared Temporality, meaning that the distributed users of the virtual world share the same frame of time.
- Real time which he defines as “not turn based”.
- Shared Spatiality, which he says can include an ‘allegory’ of a space, as in text adventures. It seems this might extend to a spoken interface to a mixed reality metaverse.
- ONE Shard is a description of the WLAN network architecture, and conforms to servers in a connected open metaverse.
- Many human agents simply means that more than one person can be represented in the virtual world and corresponds to ‘social’ in our description.
- Many Software Agents corresponds to AI actors in our descriptions. Non playing characters would be the gaming equivalent.
- Virtual Interaction pertains to any ability of a user to interact actively with the persistent virtual scene, and is pretty much a given these days.
- Nonpausable isn’t even a word, but is pretty self explanatory.
- Persistence means that if human participants leave then the data of the virtual world continues. This applies to the scenes, the data representing actions, and objects and actors in the worlds.
- Avatar is interesting as it might seem that having avatar representations of connected human participants is a given. In fact the shared spaces employed by Nvidia for digital engineering do not.

Turning to industry; John Riccitiello, CEO of Unity Technologies says that metaverse is “*The next generation of the internet that is:*

- *always real-time*
- *mostly 3D*
- *mostly interactive*
- *mostly social*

- *mostly persistent*

Expanding this slightly we will us the following primitives of what we think are important for a metaverse:

- Fusing of digital and real life
- Social first
- Real time interactive 3d graphics first
- Persistent
- Supports ownership
- Supports user generated content [121]
- Open and extensible
- Low friction economic actors and actions
- Trusted / secure
- Convergence of film and games
- Blurring of IP boundaries
- Blurring of narrative flow
- Multimodal and hardware agnostic
- Mobile first experiences
- Safeguarding, and governance

There is a **lot** of work for the creative and technical industries to do to integrate human narrative creativity this nascent metaverse, and it's not even completely clear that this is possible, or even what people want.

## 7.2 History

The word metaverse was coined by the author Neal Stephenson in his 1992 novel Snowcrash. It started popping up soon after in news articles and research papers [122], but in the last five years it has been finding a new life within a silicon valley narrative. Perhaps in response to this Stephenson is now working with a company called [Lamina1](#) which actually looks a lot like the rest of this book, so perhaps we have been on the right track.

There were clear precursors to modern social VR, such as [VRML](#) in the 1990's which laid much of the groundwork for 3D content over networked computers.

It might seem that there would be a clear path from there to now, in terms of a metaverse increasingly meaning connected social virtual spaces, but this has not happened. Instead interest in metaverse as a concept waned, MMORG (described later) filled in the utility, and then recently an entirely new definition emerged. Park and Kim surveyed dozens of different historical interpretations of the word, and the generational reboot they describe makes it even less clear [123]. The concept

of the Metaverse is extremely plastic at this time (Figure 7.2).

It's arguable that what will be expanding in this chapter is more appropriately 'Cyberspace' as described by William Gibson in *Neuromancer* [124] "A *global domain within the information environment consisting of the interdependent network of information systems infrastructures including the Internet, telecommunications networks, computer systems, and embedded processors and controllers.*"

Park and Kim identify the generational inflection point which has led to the resurgence of the concept of Metaverse [123]: "*Unlike previous studies on the Metaverse based on Second Life, the current Metaverse is based on the social value of Generation Z that online and offline selves are not different.*"

Brett Leonard, writer director of *Lawnmower Man* talks about the pressing need to get out in front of moral questions in the development of metaverse applications. He stressed that wellbeing will be a crucial underpinning of the technology because of the inherent intimacy of immersion in virtual spaces. He suggests that emotional engagement with storied characters is needed to satisfy the human need for narrative, and that this should be utopian by design to stave off the worst of dystopian emergent characteristics of the technology.

The book will aim to build toward an understanding of metaverse as a useful social mixed reality, that allows low friction communication and economic activity, within groups, at a global scale. Cryptography and distributed software can assist us with globally 'true' persistence of digital data, so we will look to integrate this with our social XR. This focus on persistence, value, and trust means it's most appropriate to focus on business uses as there is more opportunity for value creation which will be important to bootstrap this technology.

This chapter will first attempt to frame the context for telepresence (the academic term for communicating through technology), and then explain the increasingly polarised options for metaverse. It's useful to precisely identify the primitives of the product we would like to see here, so this chapter is far more a review of academic literature in the field, culminating in a proposed framework.

### 7.3 Video conferencing, the status quo

This section has been adapted and updated for open source release, from the authors PhD thesis, with the permission of the University of Salford.

Video-conferencing has become more popular as technology im-



Figure 7.2: Elon Musk agrees with this on Twitter. It's notable that Musk is now Twitters' biggest shareholder, and has been vocal about Web2 censorship on the platform.

proves, as it gets better integrated with ubiquitous cloud business support suites, and as a function of the global pandemic and changing work patterns. There is obviously increasing demands for real-time communication across greater distances.

The full effects of video-conferencing on human communication are still being explored, as seen in the experimental “Together Mode” within Microsoft Teams. Video-conferencing is presumed to be a somewhat richer form of communication than email and telephone, but not quite as informative as face-to-face communication.

In this section we look at the influence of eye contact on communication and how video-conferencing mediates both verbal and non-verbal interactions. Facilitation of eye contact is a challenge that must be addressed so that video-conferencing can approach the rich interactions of face-to-face communication. This is an even bigger problem in the emerging metaverse systems, so it’s important that we examine the history and trajectory.

There is a tension emerging for companies who do not necessarily need to employ remote meeting technology, but also cannot afford to ignore the competitive advantages that such systems bring. In an experiment performed well before the 2020 global pandemic at CTrip, Bloom et al describe how home working led to a 13% performance increase, of which about 9% was from working more minutes per shift (fewer breaks and sick-days) and 4% from more calls per minute (attributed to a quieter working environment) [125]. Home workers also reported improved work satisfaction and experienced less turnover, but their promotion rate conditional on performance fell. This speaks

to a lack of management capability with such systemic change. It's clearly a complex and still barely understood change within business and management.

Due to the success of the experiment, Ctrip rolled-out the option to work from home to the whole company, and allowed the experimental employees to re-select between the home or office. Interestingly, over half of them switched, which led to the gains almost doubling to 22%. This highlights the benefits of learning and selection effects when adopting modern management practices like working from home. Increasingly this is becoming a choice issue for prospective employees, and an advantage for hiring managers to be able to offer it.

More recent research by Barrero, Bloom and Davies found that working from home is likely to be "sticky" [126]. They found:

- better-than-expected WFH experiences,
- new investments in physical and human capital that enable WFH,
- greatly diminished stigma associated with WFH,
- lingering concerns about crowds and contagion risks,
- a pandemic-driven surge in technological innovations that support WFH.

More recently Enterprise Collaboration Systems (ECS) provide rich document management, sharing, and collaboration functionality across an organisation. The enterprise ECS system may integrate collaborative video [127]. This is for instance the case with Microsoft Teams / Sharepoint. This integration of ECS should be considered when thinking about social VR systems which wish to support business, value, and trust. It is very much the case that large technology providers are attempting to integrate their 'business back end' systems into their emerging metaverse systems. Open source equivalents are currently lacking.

### 7.3.1 Pandemic drives adoption

The ongoing global COVID-19 pandemic is changing how people work, toward a new global 'normal'. Some ways of working are overdue transformation, and will be naturally disrupted. In the UK at least it seems that there may be real appetite to shift away from old practises. This upheaval will inevitably present both challenges and opportunities.

Highly technical workforces, especially, can operate from anywhere. The post pandemic world seems to have stronger national border controls, with a resultant shortage of highly technical staff. This has forced the hand of global business toward internationally distributed teams.

If only a small percentage of companies allow the option of remote

working, then they gain a structural advantage, enjoying benefits of reduced travel, lower workplace infection risk across all disease, and global agility for the personnel. Building and estate costs will certainly be reduced. More diversity may be possible. Issues such as sexual harassment and bullying may be reduced. With reduced overheads product quality may increase. If customers are happier with their services, then over time this ‘push’ may mean an enormous shift away from centralised working practises toward distributed working.

Technologies which support this working style were still in their infancy at the beginning of the pandemic. The rush to ‘Zoom’, a previously relatively unknown and insecure [128] web meeting product, shows how naive businesses were in this space.

Connection of multiple users is now far better supported, with Zoom and Microsoft Teams alone supporting hundreds of millions of chats a day. This is a 20x increase on market leader Skype’s 2013 figure of 280 million connections per month. Such technologies extend traditional telephony to provide important multi sensory cues. However, these technologies demonstrate shortfalls compared to a live face-to-face meeting, which is generally agreed to be optimal for human-human interaction [129].

While the research community and business are learning how to adapt working practises to web based telepresence [130], there remains little technology support for ad-hoc serendipitous meetings between small groups. It’s possible that Metaverse applications can help to fill this gap, by gamification of social spaces, but the under discussed problems with video conferencing are likely to be even worse in such systems.

Chris Herd of “FirstBase” (who admittedly have a bias) provides some fascinating speculations:

*“I’ve spoken to 2,000+ companies with 40M+ employees about remote work in the last 12 months A few predictions of what will happen before 2030:*

- *Rural Living: World-class people will move to smaller cities, have a lower cost of living & higher quality of life.*
- *These regions must innovate quickly to attract that wealth. Better schools, faster internet connections are a must.*
- *Async Work: Offices are instantaneous gratification distraction factories where synchronous work makes it impossible to get stuff done.*
- *Tools that enable asynchronous work are the most important thing globally remote teams need. A lot of startups will try to*

tackle this.

- *Hobbie Renaissance: Remote working will lead to a rise in people participating in hobbies and activities which link them to people in their local community.*
- *This will lead to deeper, more meaningful relationships which overcome societal issues of loneliness and isolation.*
- *Diversity & Inclusion: The most diverse and inclusive teams in history will emerge rapidly Companies who embrace it have a first-mover advantage to attract great talent globally. Companies who don't will lose their best people to their biggest competitors.*
- *Output Focus: Time will be replaced as the main KPI for judging performance by productivity and output.*
- *Great workers will be the ones who deliver what they promise consistently*
- *Advancement decisions will be decided by capability rather than who you drink beer with after work.*
- *Private Equity: The hottest trend of the next decade for private equity will see them purchase companies, make them remote-first The cost saving in real-estate at scale will be eye-watering. The productivity gains will be the final nail in the coffin for the office Working Too Much: Companies worry that the workers won't work enough when operating remotely.*
- *The opposite will be true and become a big problem.*
- *Remote workers burning out because they work too much will have to be addressed.*
- *Remote Retreats: Purpose-built destinations that allow for entire companies to fly into a campus for a synchronous week.*
- *Likely staffed with facilitators and educators who train staff on how to maximize effectiveness.*
- *Life-Work Balance: The rise of remote will lead to people re-prioritizing what is important to them.*
- *Organizing your work around your life will be the first noticeable switch. People realizing they are more than their job will lead to deeper purpose in other areas.*
- *Bullshit Tasks: The need to pad out your 8 hour day will evaporate, replaced by clear tasks and responsibilities.*
- *Workers will do what needs to be done rather than wasting their trying to look busy with the rest of the office*

### 7.3.2 Point to Point Video Conferencing

O'Malley et al. showed that face-to-face and video mediated employed visual cues for mutual understanding, and that addition of video to the audio channel aided confidence and mutual understanding. However, video mediated did not provide the clear cues of being co-located [131].

Dourish et al. make a case for not using face-to-face as a baseline for comparison, but rather that analysis of the efficacy of remote tele-collaboration tools should be made in a wider context of connected multimedia tools and 'emergent communicative practises' [132]. While this is an interesting viewpoint it does not necessarily map well to a recreation of the ad-hoc meeting.

There is established literature on human sensitivity to eye contact in both 2D and 3D VC [133, 134], with an accepted minimum of 5-10 degrees before observers can reliably sense they are not being looked at [135]. Roberts et al. suggested that at the limit of social gaze distance (4m) the maximum angular separation between people standing shoulder to shoulder in the real world would be around 4 degrees[136].

Sellen found limited impact on turn passing when adding a visual channel to audio between two people when using Hydra, an early system which provided multiple video conference displays in an intuitive spatial distribution[137]. She did however, find that the design of the video system affected the ability to hold multi-party conversations [138].

Monk and Gale describe in detail experiments which they used for examining gaze awareness in communication which is mediated and unmediated by technology. They found that gaze awareness increased message understanding [139].

Both Kuster et al. and Gemmel et al. have successfully demonstrated software systems which can adjust eye gaze to correct for off axis capture in real time video systems[140, 141].

Shahid et al. conducted a study on pairs of children playing games with and without video mediation and concluded that the availability of mutual gaze affordance enriched social presence and fun, while its absence dramatically affects the quality of the interaction. They used the 'Networked Minds', a social presence questionnaire.

### 7.3.3 Triadic and Small Group

Early enthusiasm in the 1970's for video conferencing, as a medium for small group interaction quickly turned to disillusionment. It was

agreed after a flurry of initial research that the systems at the time offered no particular advantage over audio only communication, and at considerable cost [142].

Something in the breakdown of normal visual cues seems to impact the ability of the technology to support flowing group interaction. Nonetheless, some non-verbal communication is supported in VC with limited success.

Additional screens and cameras can partially overcome the limitation of no multi-party support (that of addressing a room full of people on a single screen) by making available more bidirectional channels. For instance, every remote user can be a head on a screen with a corresponding camera. The positioning of the screens must then necessarily match the physical organization of the remote room.

Egido provides an early review of the failure of VC for group activity, with the “misrepresentation of the technology as a substitute for face-to-face” still being valid today [143].

Commercial systems such as Cisco Telepresence Rooms cluster their cameras above the centre screen of three for meetings using their telecollaboration product, while admitting that this only works well for the central seat of the three screens. They also group multiple people on a single screen in what Workhoven et al. dub a “non-isotropic” configuration [144]. They maintain that this is a suitable trade off as the focus of the meeting is more generally toward the important contributor in the central seat. This does not necessarily follow for less formal meeting paradigms.

In small groups, it is more difficult to align non-verbal cues between all parties, and at the same time, it is more important because the hand-offs between parties are more numerous and important in groups. A breakdown in conversational flow in such circumstances is harder to solve. A perception of the next person to talk must be resolved for all parties and agreed upon to some extent.

However, most of the conventional single camera, and expensive multi camera VC systems, suffer a fundamental limitation in that the offset between the camera sight lines and the lines of actual sight introduce incongruities that the brain must compensate for [129].

#### 7.3.4 Other Systems to Support Business

There have been many attempts to support group working and rich data sharing between dispersed groups in a business setting. So called ‘smart spaces’ allow interaction with different displays for different activities and add in some ability to communicate with remote or even mobile

collaborators on shared documents [145], with additional challenges for multi-disciplinary groups who are perhaps less familiar with one or more of the technology barriers involved [146].

Early systems like clearboard [147] demonstrated the potential for smart whiteboards with a webcam component for peer-to-peer collaborative working. Indeed it is possible to support this modality with Skype and a smartboard system (and up to deployments such as Accessgrid). They remain relatively unpopular however.

### 7.3.5 **Mona Lisa Type Effects**

Almost all traditional group video meeting tools suffer from the so-called Mona Lisa effect which describes the phenomenon where the apparent gaze of a portrait or 2 dimensional image always appears to look at the observer regardless of the observer's position [148, 149, 150]. This situation manifests when the painted or imaged subject is looking into the camera or at the eyes of the painter [151, 152].

Single user-to-user systems based around bidirectional video implicitly align the user's gaze by constraining the camera to roughly the same location as the display. When viewed away from this ideal axis, it creates the feeling of being looked at regardless of where this observer is [153, 148, 149, 150], or the "collapsed view effect" [154] where perception of gaze transmitted from a 2 dimensional image or video is dependent on the incidence of originating gaze to the transmission medium.

Multiple individuals using one such channel can feel as if they are being looked at simultaneously, leading to a breakdown in the normal non-verbal communication which mediates turn passing [155]. There is research investigating this sensitivity when the gaze is mediated by a technology, finding that "disparity between the optical axis of the camera and the looking direction of a looker should be at most 1.2 degrees in the horizontal direction, and 1.7 degrees in vertical direction to support eye contact" [134, 156]. It seems that humans assume that they are being looked at unless they are sure that they are not [135].

To be clear, there are technological solutions to this problem, but it's useful in the context of discussing metaverse to know that this problem exists. It's known that there are cognitive dissonances around panes of video conference images, but it seems that the effect is truly limited to 2D surfaces. A 3D projection surface (a physical model of a human) designed to address this problem completely removed the Mona Lisa effect [153].

Metaverse then perhaps offers the promise of solving this, making

more natural interaction possible, but it's clearly a long way from delivering on those promises right now. We need to understand what's important and try to map these into a metaverse product.

## 7.4 What's important for human communication

### 7.4.1 Vocal

The ubiquitous technology to mediate conversation is, of course, the telephone. The 2021 Ericsson mobility report states that there are around 8 billion mobile subscriptions globally. More people have access to mobile phones than to working toilets according to UNICEF.

Joupii and Pan designed a system which focused attention on spatially correct high definition audio. They found "significant improvement over traditional audio conferencing technology, primarily due to the increased dynamic range and directionality. [157]. Aoki et al. also describe an audio only system with support for spatial cues [158].

In the following sections we will attempt to rigorously identify just what is important for our proposed application of business centric communication, supportive of trust, and thereby value transfer.

In his book 'Bodily Communication' [159] Michael Argyle divides vocal signals into the following categories:

1. Verbal
2. Non-Verbal Vocalisations
  - a. Linked to Speech
    - i. Prosodic
    - ii. Synchronising
    - iii. Speech Disturbances
  - b. Independent of Speech
    - i. Emotional Noises
    - ii. Paralinguistic (emotion and interpersonal attitudes)
    - iii. Personal voice and quality of accent

Additional to the semantic content of verbal communication there is a rich layer of meaning in pauses, gaps, and overlaps [160] which help to mediate who is speaking and who is listening in multi-party conversation. This mediation of turn passing, to facilitate flow, is by no means a given and is highly dependent on context and other factors [161]. Interruptions are also a major factor in turn passing.

This extra-verbal content [162] extends into physical cues, so-called 'nonverbal' cues, and there are utterances which link the verbal and

non-verbal [163]. This will be discussed later, but to an extent, it is impossible to discuss verbal communication without regard to the implicit support which exists around the words themselves.

In the context of all technology-mediated conversation the extra-verbal is easily compromised if technology used to support communication over a distance does not convey the information, or conveys it badly. This can introduce additional complexity [163].

These support structures are pretty much lacking in metaverse XR systems. The goal then here perhaps is to examine the state-of-the-art, and remove as many of the known barriers as possible. Such a process might better support trust, which might better support the kind of economic and activity we seek to engineer.

When examining just verbal / audio communication technology it can be assumed that the physical non-verbal cues are lost, though not necessarily unused. In the absence of non-verbal cues it falls to timely vocal signals to take up the slack when framing and organising the turn passing. For the synchronising of vocal signals between the parties to be effective the systemic delays must remain small. System latency, the inherent delays added by the communication technology, can allow slips or a complete breakdown of 'flow' [164]. This problem can be felt in current social VR platforms, though people don't necessarily identify the cause of the breakdown correctly. In the main they feel to the users like a bad "audio-only" teleconference.

With that said, the transmission of verbal / audio remains the most critical element for interpersonal communication as the most essential meaning is encoded semantically. There is a debate about ratios of how much information is conveyed through the various human channels [165], but it is reasonable to infer from its ubiquity that support for audio is essential for meaningful communication over a distance. We have seen that it must be timely, to prevent a breakdown of framing, and preferably have sufficient fidelity to convey sub-vocal utterances.

For social immersive VR for business users, a real-time network such as websockets, RTP, or UDP seems essential, much better microphones are important, and the system should support both angular spatialisation, and respond to distance between interlocutors.

## 7.4.2 Nonverbal

We have already seen that verbal exchanges take place in a wider context of sub vocal and physical cues. In addition, the spatial relationship between the parties, their focus of attention, their gestures and actions, and the wider context of their environment all play a part in communi-

cation [166]. These are identified as follows by Gillies and Slater [167] in their paper on virtual agents.

- Posture and gesture
- Facial expression
- Gaze
- Proxemics
- Head position and orientation
- Interactional synchrony

This is clearly important for our proposed metaverse application. Below we will examine these six areas by looking across the wider available research.

#### 7.4.2.1 Gaze

Of particular importance is judgement of eye gaze which is normally fast, accurate and automatic, operating at multiple levels of cognition through multiple cues [159, 168, 169, 168, 170, 171, 139].

Gaze in particular aids smooth turn passing [172] [173] and lack of support for eye gaze has been found to decrease the efficiency of turn passing by 25% [174].

There are clear patterns to eye gaze in groups, with the person talking, or being talked to, probably also being looked at [175] [176]. To facilitate this groups will tend to position themselves to maximally enable observation of the gaze of the other parties [171]. This intersects with proxemics which will be discussed shortly. In general people look most when they are listening, with short glances of 3-10 seconds [169]. Colburn et al. suggest that gaze direction and the perception of the gaze of others directly impacts social cognition [177] and this has been supported in a follow up study [178].

The importance of gaze is clearly so significant in evolutionary terms that human acuity for eye direction is considered high at 30 sec arc [179] with straight binocular gaze judged more accurately than straight monocular gaze [180], when using stereo vision.

Regarding the judgement of the gaze of others, Symons et al. suggested that “people are remarkably sensitive to shifts in a person’s eye gaze” in triadic conversation [179]. This perception of the gaze of others operates at a low level and is automatic. Langton et al. cite research stating that the gaze of others is “able to trigger reflexive shifts of an observer’s visual attention” and further discuss the deep biological underpinnings of gaze processing [176].

When discussing technology-mediated systems, Vertegaal & Ding suggested that understanding the effects of gaze on triadic conversation

is “crucial for the design of teleconferencing systems and collaborative virtual environments” [155], and further found correlation between the amount of gaze, and amount of speech. Vertegaal & Slagter suggest that “gaze function(s) as an indicator of conversational attention in multiparty conversations” [175]. It seems like if we are to have useful markets within social immersive environments then support for natural gaze effects should be a priority.

Wilson et al. found that subjects can “discriminate gaze focused on adjacent faces up to [3.5m]” [181]. This perhaps gives us a testable benchmark within a metaverse application which is eye gaze enabled. In this regard Schrammel et al. investigated to what extent embodied agents can elicit the same responses in eye gaze detection [182].

Vertegaal et al. found that task performance was 46% better when gaze was synchronised in their telepresence scenario. As they point out, gaze synchronisation (temporal and spatial) is ‘commendable’ in all such group situations, but the precise utility will depend upon the task [155].

There has been some success in the automatic detection of the focus of attention of participants in multi party meetings [183, 184]. More recently, eye tracking technologies allow the recording and replaying of accurate eye gaze information [185] alongside information about pupil dilation toward determination of honesty and social presence [186]. It seems there are trust and honesty issues conflated with how collaborators in a virtual space are represented.

In summary, gaze awareness does not just mediate verbal communication but rather is a complex channel of communication in its own right. Importantly, gaze has a controlling impact on those who are involved in the communication at any one time, including and excluding even beyond the current participants. Perhaps the systems we propose in this book need to demand eye gaze support, but it is clear that it should be recommended, and that the software selected should support the technology integration in principle.

#### 7.4.2.2 Mutual Gaze

Aygle and Cook established early work around gaze and mutual gaze, with their seminal book of the same title [168], additionally detailing confounding factors around limitations and inaccuracies in observance of gaze and how this varies with distance [170, 159, 187].

Mutual gaze is considered to be the most sophisticated form of gaze awareness with significant impact on dyadic conversation especially [187, 161, 188]. The effects seem more profound than just helping to

mediate flow and attention, with mutual eye gaze aiding in memory recall and the formation of impressions [189].

While reconnection of mutual eye gaze through a technology boundary does not seem completely necessary it is potentially important, with impact on subtle elements of one-to-one communication, and therefore discrimination of eye gaze direction should be bi-directional if possible, and if possible have sufficient accuracy to judge direct eye contact. In their review Bohannon et al. said that the issue of rejoining eye contact must be addressed in order to fully realise the richness of simulating face-to-face encounters [189].

Mutual gaze is a challenging affordance as bi-directional connection of gaze is not a trivial problem. It's perhaps best to view this as at the 'edge' of our requirements for a metaverse.

#### 7.4.2.3 Mutual Gaze in Telepresence

We have seen that transmission of attention can broadly impact communication in subtle ways, impacting empathy, trust, cognition, and co-working patterns. Mutual gaze (looking into one another's eyes), is currently the high water mark for technology-mediated conversation.

Many attempts have been made to re-unite mutual eye gaze when using tele-conferencing systems. In their 2015 review of approaches Regenbrecht and Langlotz found that none of the methods they examined were completely ideal [190]. They found most promise in 2D and 3D interpolation techniques, which will be discussed in detail later, but they opined that such systems were very much ongoing research and lacked sufficient optimisation.

A popular approach uses the so called 'Pepper's Ghost' phenomenon [191], where a semi silvered mirror presents an image to the eye of the observer, but allows a camera to view through from behind the angled mirror surface. The earliest example of this is Rosental's two way television system in 1947 [192], though Buxton et al. 'Reciprocal Video Tunnel' from 1992 is more often cited [193]. This optical characteristic isn't supported by retroreflective projection technology, and besides requires careful control of light levels either side of the semi-silvered surface.

The early GAZE-2 system (which makes use of Pepper's ghost) is novel in that it uses an eye tracker to select the correct camera from several trained on the remote user. This ensures that the correct returned gaze (within the ability of the system) is returned to the correct user on the other end of the network [194]. Mutual gaze capability is later highlighted as an affordance supported or unsupported by key research

and commercial systems.

#### 7.4.2.4 Head Orientation

Orientation of the head (judged by the breaking of bilateral symmetry and alignment of nose) is a key factor when judging attention. Perception of head orientation can be judged to within a couple of degrees [181].

It has been established that head gaze can be detected all the way out to the extremis of peripheral vision, with accurate eye gaze assessment only achievable in central vision [151]. This is less of use for our metaverses at this time, because user field of view is almost always restricted in such systems. More usefully, features of illumination can alter the apparent orientation of the head [195].

Head motion over head orientation is a more nuanced proposition and can be considered a micro gesture [196]. Head tracking systems within head mounted displays can certainly detect these tiny movements, but it's clear that not all of this resolution is passed into shared virtual settings through avatars. It would be beneficial to be able to fine tune this feature within any software selected.

It is possible that 3D displays are better suited to perception of head gaze since it is suggested that they are more suitable for “shape understanding tasks” [197]

Bailenson, Baell, and Blascovich found that giving avatars rendered head movements in a shared virtual environment decreased the amount of talking, possibly as the extra channel of head gaze was opened up. They also reported that subjectively, communication was enhanced [198].

Clearly head orientation is an important indicator of the direction of attention of members of a group and can be discerned even in peripheral vision. This allows the focus of several parties to be followed simultaneously and is an important affordance to replicate on any multi-party communication system.

#### 7.4.2.5 Combined Head and Eye Gaze

Rienks et al. found that head orientation alone does not provide a reliable cue for identification of the speaker in a multiparty setting [199]. Stiefelhagen & Zhu found “that head orientation contributes 68.9% to the overall gaze direction on average” [184], though head and eye gaze seem to be judged interdependently [180]. Langton noted that head and eye gaze are “mutually influential in the analysis of social attention” [176], and it is clear that transmission of ‘head gaze’ by any

mediating system, enhances rather than replaces timely detection of subtle cues. Combined head and eye gaze give the best of both worlds and extend the lateral field of view in which attention can be reliably conveyed to others [151].

#### 7.4.2.6 Other Upper Body: Overview

While it is well evidenced that there are advantages to accurate connection of the gaze between conversational partners [170, 161], there is also a body of evidence that physical communication channels extend beyond the face [161, 200] and include both micro (shrugs, hands and arms), and macro movement of the upper body [201]. Goldin-Meadow suggests that gesturing aids conversational flow by resolving mismatches and aiding cognition [202].

In their technology-mediated experiment which compared face to upper body and face on a flat screen, Nguyen and Canny found that “upper-body framing improves empathy measures and gives results not significantly different from face-to-face under several empathy measures” [200].

The upper body can be broken up as follows:

##### **Facial**

Much emotional context can be described by facial expression (display) alone [201, 203], with smooth transition between expressions seemingly important [204]. This suggests that mediating technologies should support high temporal resolution, or at least that there is a minimum resolution between which transitions between expressions become too ‘categorical’. Some aspects of conversational flow appear to be mediated in part by facial expression [205]. There are gender differences in the perception of facial affect [206].

##### **Gesturing**

(such as pointing at objects) paves the way for more complex channels of human communication and is a basic and ubiquitous channel [207]. Conversational hand gestures provide a powerful additional augmentation to verbal content [208].

##### **Posture**

Some emotions can be conveyed through upper body configurations alone. Argyle details some of these [159] and makes reference to the posture of the body and the arrangement of the arms (i.e. folded across the chest). These are clearly important cues. Kleinsmith and Bianchi-Berthouze assert that "some affective expressions may be better communicated by the body than the face" [209].

##### **Body Torque**

In multi-party conversation, body torque, that is the rotation of the trunk from front facing, can convey aspects of attention and focus [210].

In summary, visual cues which manifest on the upper body and face can convey meaning, mediate conversation, direct attention, and augment verbal utterances.

#### 7.4.2.7 Effect of Shared Objects on Gaze

Ou et al. detail shared task eye gaze behaviour “in which helpers seek visual evidence for workers’ understanding when they lack confidence of that understanding, either from a shared, or common vocabulary” [211].

Murray et al. found that in virtual environments, eye gaze is crucial for discerning what a subject is looking at [212]. This work is shown in Figure 7.3.

It is established that conversation around a shared object or task, especially a complex one, mitigates gaze between parties [168] and this suggests that in some situations around shared tasks in metaverses it may be appropriate to reduce fidelity of representation of the avatars.

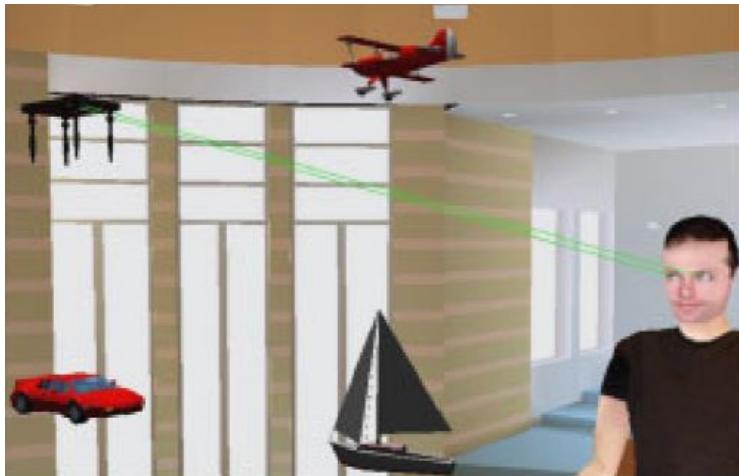


Figure 7.3: Eye tracked eye gaze awareness in VR. Murray et al. used immersive and semi immersive systems alongside eye trackers to examine the ability of two avatars to detect the gaze awareness of a similarly immersed collaborator.

#### 7.4.2.8 Tabletop and Shared Task

In early telepresence research Buxton and William argued through examples that “effective telepresence depends on quality sharing of both person and task space [193].

In their triadic shared virtual workspace Tang et al. found difficulty in reading shared text using a ‘round the table’ configuration, a marked preference for working collaboratively on the same side of the table. They also found additional confusion as to the identity of remote participants [213]. Tse et al. found that pairs can work well over a shared digital tabletop, successfully overcoming a single user interface to interleave tasks [214].

Tang et al. demonstrate that collaborators engage and disengage around a group activity through several distinct, recognizable mechanisms with unique characteristics [215]. They state that tabletop interfaces should offer a variety of tools to facilitate this fluidity.

Camblend is a shared workspace with panoramic high resolution video. It maintains some spatial cues between locations by keeping a shared object in the video feeds [216, 217]. Participants successfully resolved co-orientation within the system.

The t-room system implemented by Luff et al. surrounds co-located participants standing at a shared digital table with life sized body and head video representations of remote collaborators [218] but found that there were incongruities in the spatial and temporal matching between the collaborators which broke the flow of conversation. Tuddenham et al. found that co-located collaborators naturally devolved ‘territory’ of working when sharing a task space, and that this did not happen the same way with a tele-present collaborator [219]. Instead remote collaboration adapted to use a patchwork of ownership of a shared task. It seems obvious to say that task ownership is a function of working space, but it is interesting that the research found no measurable difference in performance when the patchwork coping strategy was employed.

The nature of a shared collaborative task and/or interface directly impacts the style of interaction between collaborators. This will have a bearing on the choice of task for experimentation [220, 221].

## 7.5 Psychology of Technology-Mediated Interaction

### 7.5.1 Proxemics

Proxemics is the formal study of the regions of interpersonal space begun in the late 50's by Hall and Sommers and building toward The Hidden Dimension [222], which details bands of space (Figure 7.4) that are implicitly and instinctively created by humans and which have a direct bearing on communication. Distance between conversational

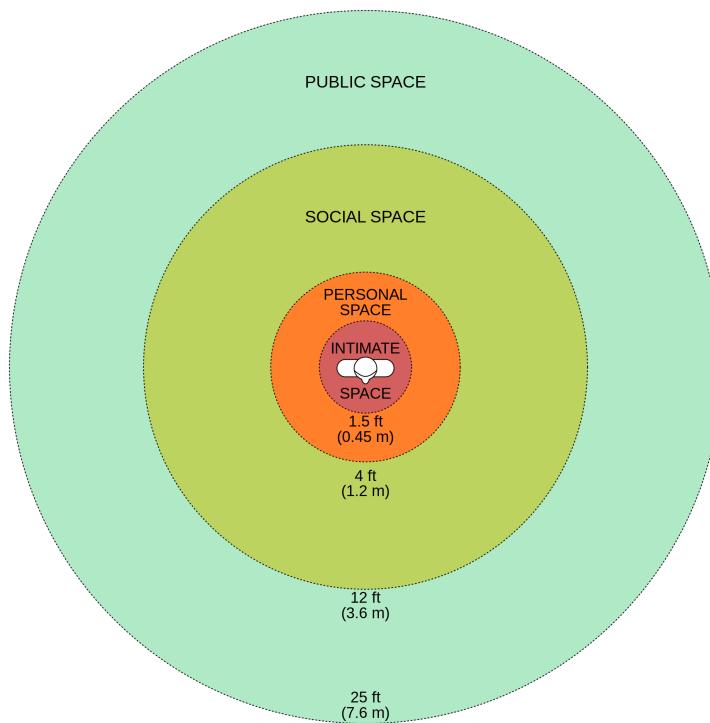


Figure 7.4: Bands of social space around a person Image CC0 from wikipedia.

partners, and affiliation, also have a bearing on the level of eye contact [169] with a natural distance equilibrium being established and developed throughout, through both eye contact and a variety of subtle

factors. Argyle & Ingham provide levels of expected gaze and mutual gaze against distance [170]. These boundaries are altered by ethnicity [223, 159] and somewhat by gender [224], and age [225, 206].

Even with significant abstraction by communication systems (such as SecondLife) social norms around personal space persist [226, 227, 228]. Bailenson & Blascovich found that even in Immersive Collaborative Virtual Environments (ICVE's) "participants respected personal space of the humanoid representation" [227] implying that this is a deeply held 'low-level' psychophysical reaction [229]. The degree to which this applies to non-humanoid avatars seems under explored.

Maeda et al. [230] found that seating position impacts the level of engagement in teleconferencing. Taken together with the potential for reconfiguration within the group as well as perhaps signalling for the attention of participants outside of the confines of the group in an open business metaverse setting.

When considering the attention of engaging with people outside the confines of a meeting Hager et al. found that gross expressions can be resolved by humans over long distances [231, 159]. It seems that social interaction begins around 7.5m in the so-called 'public space' [222]. Recreating this affordance in a metaverse would be a function of the display resolution, and seems another 'stretch goal' rather than a core requirement.

### **7.5.2 Attention**

The study of attention is a discrete branch of psychology. It is the study of cognitive selection toward a subjective or objective sub focus, to the relative exclusion of other stimuli. It has been defined as "a range of neural operations that selectively enhance processing of information" [232]. In the context of interpersonal communication it can be refined to apply to selectively favouring a conversational agent or object or task above other stimuli in the contextual frame.

Humans can readily determine the focus of attention of others in their space [183] and preservation of the spatial cues which support this are important for technology-mediated communication [137] [184].

The interplay between conversational partners, especially the reciprocal perception of attention, is dubbed the perceptual crossing [233, 234].

This is a complex field of study with gender, age, and ethnicity all impacting the behaviour of interpersonal attention [235, 225, 159, 206, 236]. Vertegaal has done a great deal of work on awareness and attention in technology-mediated situations and the work of his

group is cited throughout this chapter [237]. As an example it is still such a challenge to “get” attention through mediated channels of communication, that some research [238, 137] and many commercial systems such as ‘blackboard collaborate’, Zoom, and Teams use tell tale signals (such as a microphone icon) to indicate when a participant is actively contributing. Some are automatic, but many are still manual, requiring that a user effectively hold up a virtual hand to signal their wish to communicate.

Langton et al. cite research stating that the gaze of others is “able to trigger reflexive shifts of an observer’s visual attention”.

Regarding the attention of others, Fagal et al demonstrated that eye visibility impacts collaborative task performance when considering a shared task [188]. Novick et al. performed analysis on task hand-off gaze patterns which is useful for extension into shared task product design [173].

### 7.5.3 Behaviour

Hedge et al. suggested that gaze interactions between strangers and friends may be different which could have an impact on the kinds of interactions a metaverse might best support [172]. Voida et al. elaborate that prior relationships can cause “internal fault lines” in group working [239]. When new relationships are formed the “primary concern is one of uncertainty reduction or increasing predictability about the behaviour of both themselves and others in the interaction” [240]. This concept of smoothness in the conversation is a recurring theme, with better engineered systems introducing less extraneous artefacts into the communication, and so disturbing the flow less. Immersive metaverse are rife with artefacts.

In a similar vein the actor-observer effect describes the mismatch between expectations which can creep into conversation. Conversations mediated by technology can be especially prone to diverging perceptions of the causes of behaviour [241]. Basically this means misunderstandings happen, and are harder to resolve with more mediating technology.

Interacting subjects progress conversation through so-called ‘perception-action’ loops which are open to predictive modelling through discrete hidden Markov models [242]. This might allow product OKR testing of the effectiveness of engineered systems [243].

It may be that the perception-behaviour link where unconscious mirroring of posture bolsters empathy between conversational partners, especially when working collaboratively [244], and the extent to

which posture is represented through a communication medium may be important.

Landsberger posited the Hawthorne effect [245]. Put simply this is a short term increase in productivity that may occur as a result of being watched or appreciated. The impression of being watched changes gaze patterns during experimentation, with even implied observation through an eye tracker modifying behaviour [246].

There are also some fascinating findings around the neural correlates of gratitude, which turn out not to be linked to gratitude felt by a participant, but rather the observation of gratitude received within a social context [247]. These findings have potentially useful implications for the behaviours of AI actors and avatars within an immersive social scene.

There is much historic work describing “the anatomy of cooperation” [248], and this might better inform how educational or instructional tasks are built in metaverse applications.

Cuddihy and Walters defined an early model for assessing desktop interaction mechanisms for social virtual environments [249].

### **7.5.3.1 Perception Of Honesty**

Hancock et al. state that we are most likely to lie, and to be lied to, on the telephone [250]. Technology used for communication impacts interpersonal honesty. It seems that at some level humans know this; lack of eye contact leads to feelings of deception, impacting trust [251]. This has a major impact on immersive social XR, which often does not support mutual gaze. Trust is crucial for business interactions.

Further there are universal expressions, micro-expressions, and blink rate which can betray hidden emotions [252], though the effects are subtle and there is a general lack of awareness by humans of their abilities in this regard [251]. Absence of support for such instinctive cues inhibits trust [253]. Support for these rapid and transient facial features demands high resolution reproduction in both resolution and time domains. There is detectable difference in a participant’s ability to detect deception when between video conference mediated communication and that mediated by avatars [186]. Systems should aim for maximally faithful reproduction.

### **7.5.4 Presence, Co-presence, and Social Presence**

Presence is a heavily cited historic indicator of engagement in virtual reality, though the precise meaning has been interpreted differently by different specialisms [254, 255]. It is generally agreed to be the ‘sense

of being' in a virtual environment [256]. Slater extends this to include the "extent to which the VE becomes dominant".

Beck et al. reviewed 108 articles and synthesised an ontology of presence [254] which at its simplest is as follows:

1. Sentient presence
  - a. Physical interaction
  - b. Mental interaction
2. Non-sentient
  - a. Physical immersion
  - b. Mental immersion = psychological state

When presence is applied to interaction it may be split into Telepresence, and Co/Social presence [257, 258]. Co-presence and/or social presence is the sense of "being there with another", and describes the automatic responses to complex social cues [259, 260]. Social presence (and co-presence) refers in this research context to social presence which is mediated by technology (even extending to text based chat [261]), and has its foundations in psychological mechanisms which engender mutualism in the 'real'. This is analysed in depth by Nowak [262]. An examination of telepresence, co-presence and social presence necessarily revisits some of the knowledge already elaborated.

The boundaries between the three are blurred in research with conflicting results presented [263]. Biocca et al. attempted to enumerate the different levels and interpretations surrounding these vague words [264], and to distill them into a more robust theory which better lends itself to measurement. They suggest a solid understanding of the surrounding psychological requirements which need support in a mediated setting, and then a scope that is detailed and limited to the mediated situation.

Since 'social presence' has been subject to varied definitions [264] it is useful here to consider a single definition from the literature which defines it as "the ability of participants in the community of inquiry to project their personal characteristics into the community, thereby presenting themselves to the other participants as real people." [265, 254]. Similarly to specifically define co-presence for this research it is taken to be the degree to which participants in a virtual environment are "accesible, available, and subject to one another" [264].

Social presence has received much attention and there are established questionnaires used in the field for measurement of the levels of perceived social presence yet the definitions here also remain broad, with some confusion about what is being measured [264].

Telepresence meanwhile is interaction with a different (usually

remote) environment which may or may not be virtual, and may or may not contain a separate social/co-presence component.

Even in simple videoconferencing Bondareva and Bouwhuis stated (as part of an experimental design) that the following determinants are important to create social presence [266, 157].

1. Direct eye contact is preserved
2. Wide visual field
3. Both remote participants appear life size
4. Possibility for participants to see the upper body of the interlocutor
5. High quality image and correct colour reproduction
6. Audio with high S/N ratio
7. Directional sound field
8. Minimization of the video and audio signal asynchrony
9. Availability of a shared working space.

Bondareva et al. went on to describe a person-to-person telepresence system with a semi-silvered mirror to reconnect eye gaze, which they claimed increased social presence indicators. Interestingly they chose a checklist of interpersonal interactions which they used against recordings of conversations through the system [266].

The idea of social presence as an indicator of the efficacy of the system, suggests the use of social presence questionnaires in the evaluation of the system [264]. Subjective questionnaires are however troublesome in measuring effectiveness of virtual agents and embodiments, with even nonsensical questions producing seemingly valid results [267]. Usoh et al. found that 'the real' produced only marginally higher presence results than the virtual [268]. It would be difficult to test products this way.

Nowak states that "A satisfactory level of co-presence with another mind can be achieved with conscious awareness that the interaction is mediated" and asserts that while the mediation may influence the degree of co-presence it is not a prohibiting factor [262].

Baren and IJsselsteijn [269, 270] list 20 useful presence questionnaires in 2004 of which "Networked Minds" seemed most appropriate for the research. Hauber et al. employed the "Networked Minds" Social Presence questionnaire experimentally and found that while the measure could successfully discriminate between triadic conversation that is mediated or unmediated by technology, it could not find a difference between 2D and 3D mediated interfaces [271, 261].

In summary, social presence and co-presence are important historic measures of the efficacy of a communication system. Use of the term in

literature peaked between 1999 and 2006 according to Google's ngram viewer and has been slowly falling off since. The questionnaire methodology has been challenged in recent research and while more objective measurement may be appropriate, the networked minds questions seem to be able to differentiate real from virtual interactions [270].

## 7.6 Other Systems to Support Business

There have been many attempts to support group working and rich data sharing between dispersed groups in a business setting. So called 'smart spaces' allow interaction with different displays for different activities and add in some ability to communicate with remote or even mobile collaborators on shared documents [145], with additional challenges for multi-disciplinary groups who are perhaps less familiar with one or more of the technology barriers involved [146].

Early systems like clearboard [147] demonstrated the potential for smart whiteboards with a webcam component for peer to peer collaborative working. Indeed it is possible to support this modality with Skype and a smartboard system (and up to deployments such as Accessgrid). They remain relatively unpopular however.

Displays need not be limited to 2 dimensional screens and can be enhanced in various ways.

Stereoscopy allows an illusion of depth to be added to a 2D image by exploiting the stereo depth processing characteristics of the human vision system. This technical approach is not perfect as it does not fully recreate the convergence and focus expected by the eyes and brain.

There are multiple approaches to separating the left and right eye images, these primarily being active (where a signal selectively blanks the input to left then right eyes in synchronicity with the display), passive, where either selective spectrum or selective polarisation of light allow different portions of a display access to different eyes, or physical arrangements which present different displays (or slices of light as in lenticular systems) to different eyes.

These barrier stereoscopy / lenticular displays use vertical light barriers built into the display to create multiple discrete channels of display which are accessed by moving horizontally with respect to the display. In this way it is possible to generate either a left/right eye image pair for 'autostereoscopic' viewing, or with the addition of head tracking and small motors. With these techniques multiple viewpoint or an adaptive realtime viewpoint update can be presented without the glasses required for active or passive stereoscopic systems.

## 7.6.1 Spatially Faithful Group

Hauber et al. combined videoconferencing, tabletop, and social presence analysis and tested the addition of 3D. They found a nuanced response when comparing 2D and 3D approaches to spatiality: 3D showed improved presence over 2D (chiefly through gaze support), while 2D demonstrated improved task performance because of task focus [272].

I3DVC reconstructs participants from multiple cameras and places them isotropically (spatially faithful) [273, 274]. The system uses a large projection screen, a custom table, and carefully defined seating positions. They discussed an “extended perception space” which used identical equipment in the remote spaces in a tightly coupled collaborative ‘booth’. It employed head tracking and multi camera reconstruction alongside large screens built into the booth. This system exemplified the physical restrictions which are required to limit the problems of looking into another space through the screen. Fuchs et al. demonstrated a similar system over a wide area network but achieved only limited resolution and frame rate with the technology of the day [275].

University of Southern California used a technically demanding real-time set-up with 3D face scanning and an autostereoscopic 3D display to generate multiple ‘face tracked’ viewpoints [276]. This had the disadvantage of displaying a disembodied head.

MAJIC is an early comparable system to support small groups with life size spatially correct video, but without multiple viewpoints onto the remote collaborators it was a one to ‘some’ system rather than ‘some’ to one. Additionally users were rooted to defined locations [277, 278].

There seems to be less interest recently in large display screens for spatially correct viewpoints between groups. The hardware is technically demanding and there may have been sufficient research done to limit investment in research questions. This doesn’t mean that there is no future for metaverse applications. Imagine one of the new XR studio walls such as that used to film the Mandalorian. With application of telepresence research it would be possible to bring external metaverse participants into the ‘backstage’ virtual scene. These avatars would be able to explore the scene invisible to the actors, but could be given access to visual feeds from the stage side. This is a hybrid virtual/real metaverse with a well researched and understood boundary interface. It would be possible to give different access privileges to different levels of paying ‘film studio tourist’ or investor, with VIPs perhaps

commanding a view onto the live filming. At the nadir of this it may be possible to bring producers and directors directly into the virtual studio as avatars on the screen boundary, with a spatially faithful view onto the set. For the purposes of this book it's also worth noting that NFTs of the experience and corresponding virtual objects from the scene could be monetised and sold within the metaverse.

### 7.6.1.1 Multiview

In order to reconnect directional cues of all kinds it is necessary for each party in the group to have a spatially correct view of the remote user which is particular for them. This requires a multi-view display, which has applications beyond telepresence but are used extensively in research which attempts to address these issues.

Nguyen and Canny demonstrated the ‘Multiview’ system [154]. Multiview is a spatially segmented system, that is, it presents different views to people standing in different locations simultaneously. They found similar task performance in trust tasks to face-to-face meetings, while a similar approach without spatial segmentation was seen to negatively impact performance.

In addition to spatial segmentation of viewpoints [279] it is possible to isolate viewpoints in the time domain. Different tracked users can be presented with their individual view of a virtual scene for a few milliseconds per eye, before another viewpoint is shown to another user. Up to six such viewpoints are supported in the c1x6 system [280] Similarly MM+Space offered 4 Degree-Of-Freedom Kinetic Display to recreate Multiparty Conversation Spaces [281]

### 7.6.2 Holography and Volumetric

Blanche et al. have done a great deal of research into holographic and volumetric displays using lasers, rotating surfaces, and light field technology [282, 283]. They are actively seeking to use their technologies for telepresence and their work is very interesting.

Similarly Jones et al. “HeadSPIN” is a one-to-many 3D video teleconferencing system [276] which uses a rotating display to render the holographic head of a remote party. They achieve transmissible and usable framerate using structured light scanning of a remote collaborator as they view a 2D screen which they say shows a spatially correct view of the onlooking parties.

Eldes et al. used a rotating display to present multi-view autostereoscopic projected images to users [284].

Seelinder is an interesting system which uses parallax barriers to

render a head which an onlooking viewer can walk around. The system uses 360 high resolution still images which means a new spatially segmented view of the head every 1 degreesof arc. They claim the system is capable of playback of video and this head in a jar multi-view system clearly has merit but is comparatively small, and as yet untested for telepresence [285].

These systems do not satisfy the requirement to render upper body for the viewers and are not situated (as described soon).

There's a future possible where real-time scanned avatar representation in persistent shared metaverse environments will be able to support business, but the camera rigs which currently generate such models are too bulky and involved for a good costs benefit analysis. It is more likely that recent advances in LIDAR phone scanning show the way. The allow realistic avatars to be quickly created for animation within metaverse scenes [286].

### **7.6.3 Simulated Humans**

#### **7.6.3.1 Uncanniness**

When employing simulation representations of humans it may be the case that there is an element of weirdness to some of these systems, especially those that currently represent a head without a body. Mori has demonstrated The Uncanny Valley [287] effect in which imperfect representations of humans elicit revulsion in certain observers. This provides a toolkit for inspecting potentially ‘weird’ representations, especially if they are ‘eerie’ and is testable through Mori’s GODSPEED questionnaire.

With an improved analysis of the shape of the likeability curve estimated later showing a more nuanced response from respondents where anthropomorphism of characters demonstrated increased likeability even against a human baseline [288, 289].

A mismatch in the human realism of face and voice also produces an Uncanny Valley response [290].

However, there is a possibility that Mori’s hypothesis may be too simplistic for practical everyday use in CG and robotics research since anthropomorphism can be ascribed to many and interdependent features such as movement and content of interaction [289].

Bartneck et al. also performed tests which suggest that the original Uncanny Valley assertions may be incorrect, and that it may be inappropriate to map human responses to human simulacrum to such a simplistic scale. They suggest that the measure has been a convenient

'escape route' for researchers [289]. Their suggestion that the measure should not hold back the development of more realistic robots holds less bearing for the main thrust of this telepresence research which seeks to capture issues with imperfect video representation rather than test the validity of an approximation.

Interestingly Ho et al. performed tests on a variety of facial representations using images. They found that facial performance is a 'double edged sword' with realism being important to robotic representations, but there also being a significant Uncanny Valley effect around 'eerie, creepy, and strange' which can be avoided by good design [291].

More humanlike representations exhibiting higher realism produce more positive social interactions when subjective measures are used [226] but not when objective measures are used. This suggests that questionnaires may be more important when assessing potential uncanniness.

A far more objective method would be to measure user responses to humans, robots, and representations with functional near-infrared spectroscopy and while this has been attempted it is early exploratory research [292], an emotional response to 'eerie' was discovered.

### 7.6.3.2 Embodiment through robots

Virtuality human representation extends beyond simple displays into robotic embodiments (which need not be humanoid [293]), shape mapped projection dubbed "shader lamps", and hybridisations of the two.

Robots which carry a videoconference style screen showing a head can add mobility and this extends the available cues [294, 295, 296, 297, 298]. Interestingly Desai and Uhlik maintain that the overriding modality should be high quality audio [299].

Tsui et al. asked 96 participants to rate how personal and interactive they found interfaces to be. Interestingly they rated videoconferencing as both more personal and more interactive than telepresence robots, suggesting that there is a problem with the overall representation or embodiment [300].

Kristoffersson et al. applied the Networked Minds questionnaire to judge presence of a telepresence robot for participants with little or no experience of videoconferencing. Their results were encouraging, though they identified that the acuity of the audio channel needing improvement [301].

There are a very few lifelike robots which can be used for telepresence, and even these are judged to be uncanny [302]. This is only

an issue for a human likeness since anthropomorphic proxies such as robots and toys perform well [287].

### 7.6.3.3 Physical & Hybrid embodiment

Embodiment through hybridisation of real-time video and physical animatronic mannequins has been investigated as a way to bring the remote person into the space in a more convincing way [303, 304, 305]. These include telepresence robots [295, 302, 296], head in a jar implementations such as SphereAvatar [306, 307, 308] and BiReality [309], UCL's Gaze Preserving Situated Multi-View Telepresence System [307], or screen on a stick style representations [298].

Nagendran et al. present a 3D continuum of these systems into which they suggest all such systems can be rated from artificial to real on the three axes, shape, intelligence, and appearance [310].

Itoh et al. describe a 'face robot' to convey captured human emotion over a distance. It uses an 'average face' and actuators to manipulate feature points [311]. It seems that this is an outlier method for communication of facial affect but demonstrates that there are many development paths to a more tangible human display.

It seems increasingly likely that machine learning models which manipulate images in real time can simulate humans into metaverse applications with very little input data. One such example is Samsung's Megaportraits which can produce a realistic human face from a single input stream such as a webcam [312].

### 7.6.3.4 Shader lamps

Projection mapping is a computational augmented projection technique where consideration of the relative positions and angles of complex surfaces allows the projection from single or multiple sources to augment the physical shapes onto which they appear. It was first considered by the Disney corporation in 1969 and was given prominence by Raskar and Fuchs with "office of the future" [313] and later by Raskar and other researchers [305]. It has since gained considerable commercial popularity in live entertainment.

Shader lamps [305] is the more formal academic designation for projection mapping. It is possible to use the technique alongside reconstruction to project onto a white facial mannequin. Researchers have attempted to use the technology for remote patient diagnostic, projecting onto styrofoam heads [314].

Bandyopadhyay et al. demonstrated [315] that it is possible to track objects and projection map [316] onto them in real time. This is beyond

the scope of the proposed projection onto furniture since we wish to keep the system as simple as possible, but could be useful for shared tasks in the future work.

Lincoln et al. employed animatronic avatars which they projected with shader lamps. This combination recreated facial expression and head movement though they were limited in speed and range of control of the remote head [304].

While shader lamps are an important and useful technology, there are limitations imposed by its use. In particular if a realtime video feed or reconstruction of a subject is used then that scanned subject must either remain still enough to be correctly mapped onto geometry on the remote side (useful for some virtual patients for instance [317], or else there must be a computational adjustment made for their changing position to make them appear static, or the projection surface must move to match their movement as in Lincoln et al.

### 7.6.3.5 Metaverse

In supporting business it's not clear that performance is improved or even maintained by the use of a metaverse. Xi et al. found a significant negative impact to productivity within metaverse applications [318]. It lowers productivity, and may increase anxiety, nausea, VR sickness and even migraines [319]. It seems at this stage that if we are determined to explore metaverse for business then we should mitigate the problems as much as possible using the understanding we have gained so far. It might seem that in so doing there is no difference between immersive collaborative mixed reality (described above) and metaverse at all. We feel that the point of metaverse may be in *access to*, if not reliance upon, a mechanism for global truth. What we will go on to describe is likely to look more like traditional telecollaboration for small focussed teams, working on real-world problems, but we will always maintain an access to both the ability to scale, and a global register of value, trust, and truth (digital assets).

## 7.7 Theoretical Framework toward metaverse

### 7.7.1 Problem Statement

It's very likely that the 'social first' metaverse attempts such as Meta Horizons, Sandbox, and Decentraland are failing to capture audiences. They will likely crash back down the hype curve as 'Second Life' did before them. Games based worlds such as Roblox are fairing better, but

it's unclear if they have any longevity, and they do not fulfil ambitions of an open metaverse.

Worse yet it seems that metaverse is not the most useful way to conduct business. It is evident that there are multiple factors which contribute to successful human-human communication. These factors remain important in telecommunication supported by technology, and are variously supported, unsupported, or modified by particular technologies. Third person large scale metaverse are clearly amongst the worse of the solutions.

Of particular importance is interpersonal gaze [187, 161, 188]. Non-verbal cues are also important across multiple modalities of sight, sound [163], and position of interlocutors [171], extending to the whole body [161, 200].

While formal meeting paradigms are pretty well supported by commercially deployed systems, such ICT can be expensive, may need to be professionally managed, and high end equipment in board rooms are generally booked well in advance. These meetings seem to demand many smaller supporting meetings between parties or groups of parties. The pressure here is clearly toward the now ubiquitous Teams and Zoom style formats, and these offer very poor support for social cues, and incur additional fatigue. These are known and well researched problems, and it is possible that the strategic pairing of Meta Horizons and Microsoft Teams will succeed where previous attempted have failed. They seem to finally have the right assets and opportunity.

The 'problem' is a supporting technology for small less formal groups, or ad-hoc groups meeting to add clarity or context to formal meetings. Metaverse allows this kind of interaction, while not seeming to replace formal meeting utility. Metaverse also may connect home and work spaces without bringing in those backgrounds, creating a level playing field. A more advanced metaverse interface could also allow dynamism and movement, connection of natural non vocal cues, without too much encumbering technology overhead.

## 7.7.2 Core Assumptions

Figure 7.5 shows the interlocking relationships between baseline communication where the participants are present, and technology which attempts to support across distance.

Of most interest to this research is the centre of the Venn where meeting styles which are less formal, and perhaps dynamic, may occur. Looking at these items one by one gives us our core assumptions.

### 1. Gaze

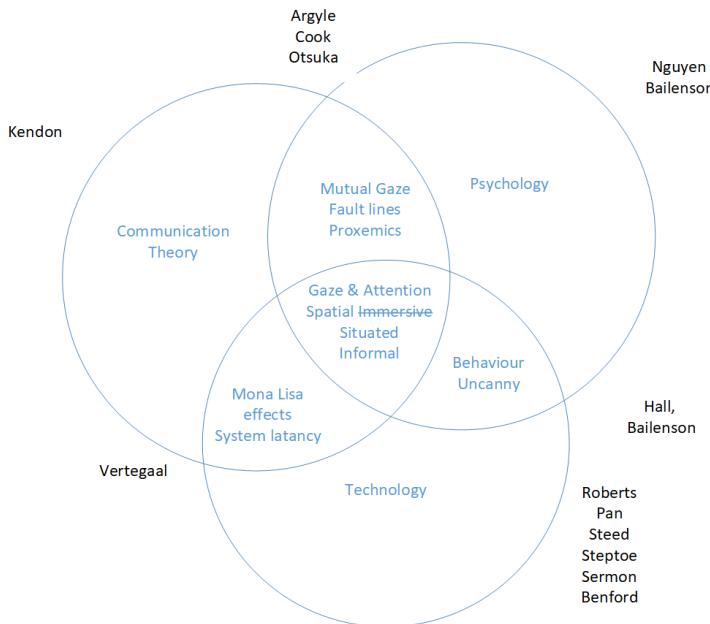


Figure 7.5: The Venn diagram shows areas of research which have been identified in blue. These interlock and overlap as shown. The most relevant identified researchers from the literature are shown in black close to the fields of study which they represent. This diagram is a view of the core assumptions for the research, with the most important fields at the centre.

Gaze is broadly agreed to be highly important for mediating flow. Mutual gaze is a rich emotional channel. The research must consider gaze. All of the researchers listed around the Venn have at some point engaged with this topic.

## 2. Attention

The non-verbal communication channel employed in ‘attention’ is assumed based upon the literature to be critical to smoothly leaving and entering a fast flowing conversation where concentration around a defined problem may be high (gesturing to a chair for instance). Again, all of the listed researchers have made reference to attention in their work.

## 3. Spatial (immersive)

Support for spatiality is important in a group setting so that

directional non-verbal cues can find their target. The topic of spatial relationships between interlocutors cuts across all of the researchers, but this is not true of immersion. Immersion in a shared virtuality can certainly support the underlying requirements spatial, but the technical infrastructure required is out of scope (so this is struck through on the diagram). Roberts and Steed are the main expertise referenced even though this element is not expanded in the research.

#### 4. Situated

Situated displays are those which are appropriate for their surrounding context, in this case the informal meeting. Roberts, Pan, Steed and Steptoe seem the most relevant researchers in these technology spaces.

#### 5. Informal

Based on the literature proxemics is believed to be relevant in a meeting where subgroups can be instantiated and destroyed as the meeting evolves, and those where people can be invited in from outside the physical bounds of the meeting (informal spaces). Hall is the best source for this work. If it is assumed that people may come and go, and subgroups may be convened then Sermon and Benford are the best references through their work blending real and virtual spaces. This may be more consistent with less organised meetings such as those convened on demand (ad-hoc).

### 7.7.3 Peripheral Assumptions

Surrounding the centre of the Venn are additional relevant topics from social science branches of theory

#### **From verbal communication**

It is assumed that the directionality of sound is important [158], and this will be engineered into the experimental design. It is assumed that movement of the lips is an indicator and this is tied to latency and frame rate in the vision system.

#### **From non-verbal communication**

It is assumed that eye gaze is of high importance, and that this information channel is supported by head gaze and body torque to a high degree. It is further assumed that mutual eye gaze is of less relevance in a multi party meeting where there is a common focus for attention but can be significant for turn passing. It is assumed that upper body framing and support for transmission of micro and macro gesturing is important for signaling attention in the broader group, and

for message passing in subgroups.

**Now that we have an idea what's important for business social communication we can look at the available software to find a best fit.**

## 7.8 Post 'Meta' metaverse

The current media around “metaverse” has been seeded by Mark Zuckerberg’s rebranding of his Facebook company to ‘Meta’, and his planned investment in the technology. Kraus et al suggest that this seems more a marketing and communication drive than a true shift in the company business model [320], but despite this Park and Kim identify dozens of recent papers of metaverse research emerging from Meta labs [123].

In Stephenson’s ‘Snow Crash’ the Hero Protagonist (drolly called Hiro Protagonist) spends much of the novel in a dystopian virtual environment called the metaverse. It is unclear if Facebook is deliberately embracing the irony of aping such a dystopian image, but certainly their known predisposition for corporate surveillance, alongside their attempt at a global digital money is ringing alarm bells, as is their current plan for monetisation.

The second order hype is likely a speculative play by major companies on the future of the internet. Grayscale investment published a report which views Metaverse as a potential trillion dollar global industry. Such industry reports are given to hyperbole, but it seems the technology is becoming the focus of technology investment narratives. Some notable exerts from a 2021 report by American bank JPMorgan show how the legacy financial institutions see this opportunity:

- In the view of the report *“The metaverse is a seamless convergence of our physical and digital lives, creating a unified, virtual community where we can work, play, relax, transact, and socialize.”* - this isn't the worst definition, and very much plays into both the value and mixed reality themes explored in this book.
- They agree with the industry that monetisation of assets in metaverse applications is called “Metanomics”. It's worth seeing this word once, as it's clearly gaining traction, but it won't be used in this book.
- They make a point which is at the core of this book, that value transaction within metaverses may remove effective border controls for working globally. Be this teleoperation of robots, education, or shop fronts in a completely immersive VR world. They

say: “*One of the great possibilities of the metaverse is that it will massively expand access to the marketplace for consumers from emerging and frontier economies. The internet has already unlocked access to goods and services that were previously out of reach. Now, workers in low-income countries, for example, may be able to get jobs in western companies without having to emigrate.*”

- There is a passage which foreshadows some of the choices made in this book: “*Expanded data analytics and reporting for virtual spaces. These will be specifically designated for commercial and marketing usage and will track business key performance indicators (this already exists in some worlds, such as Cryptovoxels)*”. More on this later.
- The report attempts to explore the web3 & cryptocurrency angles of metaverse. That’s also the aim of this book, but they have taken a much more constrained approach, ignoring the possibilities within Bitcoin.
- They assert that strong regulatory capture, identification, KYC/AML etc should underpin their vision of the metaverse. This is far from the community driven and organically emergent narratives that underpin Web3. This is their corporate viewpoint, something they have to say. On the back of this they pitch their consultancy services in these areas.

There has been a reactive pushback against commercialisation and corporateisation by the wider tech community, who are concerned about the aforementioned monetisation of biometrics. Observers do not trust these ‘Web2’ players with such a potentially powerful social medium. It is very plausible that this is all just a marketing play that goes nowhere and fizzles out. It is by no means clear that people want to spend time socialising globally in virtual and mixed reality. These major companies are making an asymmetric bet that if there is a move into virtual worlds, then they need to be stakeholders in the gatekeeping capabilities of those worlds.

## 7.9 Market analysis

The market penetration analysis for VR which rings most true for us is provided by Thrive Analytics, and ARTillery Intelligence. Their report is titled “VR Usage & Consumer Attitudes, Wave VI”. In the USA (which is the cohort they surveyed) they found that adoption of VR headsets is slower than predicted (their work is longitudinal), but steady.

Some highlight points are:

- 23 percent of U.S. adults own or *have used* VR technology. This is around 4% up from the previous survey in 2020. Frustratingly, and very much in keeping with such industry surveys they conflate ‘own’ with ‘have used’ making this data pretty meaningless from an adoption point of view.
- there is a skew toward male users of around 10%, and a far larger skew toward younger users, and a bias toward richer households. These are indicative of a technology that’s still early in its adoption cycle.
- Of the owners of the technology (no indication what percentage this is) they found that around a third used the equipment regularly, but that this retention number was gently falling.
- Standalone headsets (Quest 2 and Pico 4) without a cabled connection to a computer are far more popular, and have better user retention. This makes sense as the alternative demands either space or setup time.
- Buyers of these more popular headsets are very sensitive to price. Note here that Meta is selling Quest2 at a loss to drive the market. This is unsustainable.
- Overall this snapshot of adoption feels pretty neutral, and is being driven by losses to Facebook/Meta share price.

Deloitte have just conducted a UK survey. This covers “metaverse, virtual reality, and web3 (i.e. blockchain-based assets like Bitcoin”, and so is perfect for our needs. They have similar results to the bigger US survey. Their key finding are quoted below verbatim:

- 63% of respondents have heard of the term “metaverse”. However, roughly half of those know nothing about it.
- Only 18% of VR headsets are used daily, from the 8% of individuals that claim to have access to one.
- Consumers may be wary of web 3. While most people (93%) have heard of cryptocurrency, only one in five (19%) know at least a “fair amount” about it. Knowledge of NFTs is rarer still.
- 70% of those who have heard of these assets say they are unlikely to buy them in the next, and cite fraud, scams and a lack of regulation as key concerns.

Deloitte feel that “content is key” for virtual reality to be a success, but we would instead argue that applications are key. Nearly half of their respondents were simply “not interested in VR”. We think this matches our longstanding understanding of the reality of the market. A few vocal proponents of the technology does not necessarily lead to a

developed and mature mass appeal. Again, we feel that real world use cases will drive adoption over a longer time frame. Virtual meetings do not feel like that application to us.

They feel that ‘one metaverse’ would require blockchain/web3 tooling for a common consensus frame, and we agree with this. It seems like a very long way to that point, and perhaps not worth the effort. They, like us, see compatible silos as being the interim step.

They (unusually) have a legal opinion in the text, and this is valuable enough to quote verbatim once again. *“The metaverse amplifies existing legal issues and raises new ones. Centralised metaverses, such as those focused on games, tend to engage consumers in a controlled space and operate within familiar legal frameworks. For example, users purchasing a virtual accessory are likely to understand its use will be within tightly prescribed parameters. Decentralised metaverses, which incorporate web3 (such as NFTs) are more challenging, as users may expect virtual assets to be portable. However, those assets are governed by inconsistent and often unclear terms, and the lack of technical standards can result in limited interoperability between metaverses. For the user, social interactions in virtual worlds can feel realistic, inviting scrutiny from policymakers and regulators focused on online safety. An increased legislative focus on children online will also require platforms to assess or verify the age of users. And collection of personal data – such as eye movement within a VR headset – will require informed consent under data protection laws, and a clear understanding of who is controlling that data at any given time. Finally, as content is key, clear contractual parameters are required to frame how intellectual property is used, whether user-generated content is permitted, and how illegal/harmful content is managed. Amid all of this, metaverse builders, content owners and brands must ensure they have a risk assessment and risk management framework in place to avoid costly mistakes, both reputational and financial, in an increasingly regulated space.”*

The Drum is a market awareness website and compiled the following statistics, which have been linked back to their source and annotated for our needs.

- *89.4 million Americans are expected to use virtual reality (VR) in 2022, according to insiderintelligence. That number, according to the same source, is expected to climb to 110.3 million in 2025. As a counter to this only around 16M VR headsets were sold in 2022*
- *51% of gen Z and 48% of millennials envision doing some of*

*their work in the metaverse in the next two years, according to Microsoft's Work Trend Index 2022.*

- *38% of respondents said they would “try extreme sports like skydiving, bungee jumping, or paragliding” in the metaverse according to a recent Statista survey called ‘What things would you do in the metaverse but never in real life?’ Unsettlingly, 18% of respondents said they would “conduct unethical experiments on virtual humans”*
- *87% of Americans between the ages of 13-56 would be interested in engaging with a virtual experience in the metaverse “that is built around a celebrity they love,” according to new research from UTA and Vox Media*
- *\$678bn is forecasted to be the total market valuation of the metaverse by 2030, per Grand View Research. According to the report, that market value was just shy of*
- *\$39bn in 2021, giving it a predicted compounded annual growth rate over a 10-year period of around 39%*
- *46% of all people across age groups say that the ability to visualize a virtual product in an IRL context – “such as seeing a digital painting in their home using augmented reality (AR) glasses” – is the primary factor that would motivate them to make a purchase in the metaverse, per a Productsup survey*
- *24% of US adult internet users say “that lower-priced VR headsets were a very important factor when deciding whether to try using the metaverse,” per a recent Statista survey. On the other hand, 54% say that their workplace using the metaverse would “not [be] important at all” in their decision to give the metaverse a try*
- *15% of gen Zs’ “fun budget” is spent in the metaverse, per a report from Razorfish and Vice Media Group. In five years that number is projected to climb to 20%*
- *Nearly 77% believe that the metaverse “can cause serious harm to modern society,” per a recent survey from customer service platform Tidio. The survey, which received feedback from 1,000 participants, identified three major causes of anxiety related to the metaverse and its potentially negative social impacts: “addiction to a simulated reality” was the number one concern, followed by “privacy issues” and “mental health issues,” which were tied for second*
- *By 2026, about 2 billion people worldwide “will spend at least one hour a day in the metaverse to work, shop, attend school,*

*socialize or consume entertainment,” per McCann Worldgroup. By that same year, the total value of the virtual goods market in the metaverse could be as high as \$200bn*

- *NFTs Over \$37bn has been spent in NFT marketplaces as of May 2022, per data from Chainalysis. At their current rate, this year’s NFT sales could potentially surpass last year’s, which had a total valuation of around \$40bn, according to the data*
- *\$91.8m was the sale price of ‘The Merge,’ the most valuable NFT to date. Created by the artist Pak, it sold for its record-breaking value in December 2021*
- *64% of sports fans are open to the idea of learning more about NFTs and would consider purchasing one in the future, according to the National Research Group. The report also found that 46% of sports fans “would be more likely to attend live sporting events if they were rewarded with a commemorative NFT – for example, if their ticket turned into a digital collectible after the game”*
- *Only 9% of people aged 16-44 own a NFT, and less than half (44%) have purchased or invested in crypto, per a new survey from agency SCS. On the other hand, among the survey’s 600 respondents, 64% were “aware” of the metaverse, and 65% of that subgroup say they are “interested in exploring it further for everything from traveling to new places and playing games to making money and shopping”*

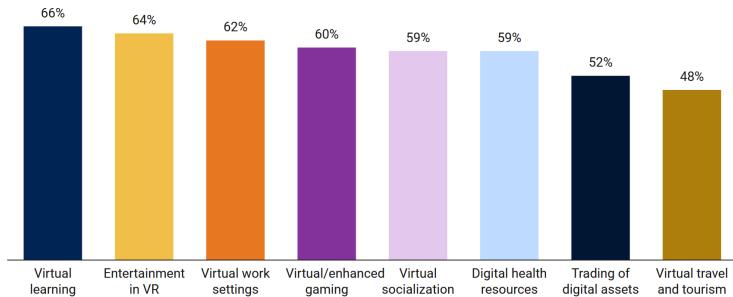
Polling company IPSOS have conducted a global survey for the World Economic Forum. Some highlights are:

- “Excitement about extended reality is significantly higher in emerging countries than it is in most high-income countries. In China, India, Peru, Saudi Arabia, and Colombia, more than two-thirds say they have positive feelings about the possibility of engaging with it.”
- “Familiarity and favorability toward the new technologies are also significantly higher among younger adults, those with a higher level of education, and men than they are among older adults, those without a college-level education, and women.”

Excitingly for our exploration of the topic it can be seen in Figure 7.6 that education within metaverse spaces is the most anticipated application, and we have seen that the emerging globals markets are the most optimistic about the technology overall. This is highly suggestive of an opportunity.

### How Metaverse applications will impact people's lives

% expecting various types of metaverse apps using XR to significantly change people's lives in the next 10 years



Source: Ipsos Global Advisor - Metaverse and Extended Reality  
• Embed • Created with Datawrapper

Figure 7.6: IPSOS poll predicted applications

## 7.10 NFT and crypto as metaverse

Within the NFT, Web3 and crypto community it is normalised to refer to ownership of digital tokens as participation in a metaverse. This is reflected in the market analysis above. This fusing of narratives is reviewed in detail by Gadekallu et al in their excellent recent paper on Metaverse and Blockchain [321]. They conclude that much remains to be done here. This CNBC article highlights the confusion, as this major news outlet refers to Walmart prepares to offer NFTs” as an entry “into the metaverse”.

## 7.11 Immersive and third person XR

In considering the needs of business to business and business to client social VR is it useful to compare software platforms. We have seen that a global connected multiverse is a marketing proposition only, and may be a decade or more away. Contenders currently look more like one of three categories; games, limited massively multiplayer worlds, or meeting support software. These will converge.

### 7.11.1 More like a digital twin

One of the most intuitive ways to view a metaverse is as a virtual landscape. This is how metaverse was portrayed in the original Neal Stephenson use of the word. ‘Digital twin’ is another much abused

industry term which trends toward a 3D representation of real world spaces and objects. Sometimes these virtual objects are connected to the real by telemetry, allowing industrial monitoring applications. Much is made of such systems in simulation brochures, and on the web, but it's surprisingly hard to find real world applications of the idea outside of complex large scale systems engineering (aerospace). The costs of maintenance are simply too high. The US army owns the digital twin which could be called closest to "The Metaverse" (note the intentional capitalisation). Their global simulation environment mirrors real world locations for their training needs. The European space agency is building an Earth digital twin for climate research, but again it's unclear what this offers over and above access to direct data feeds, and of course such an ambitious project likely has an ecological cost!

### **7.11.1.1 Geolocated AR**

Overlaying geospecific data into augmented reality (think Pokemon Go) is probably the ultimate utility of digital twin datasets. It's such a compelling application space that we will have more on this later.

### **7.11.2 More like a metaverse**

#### **7.11.2.1 Second Life**

Notable because it's the original and has a decently mature marketplace. Some \$80M was paid to creators in Second Life in 2021 in a wider economic ecosystem of around \$650M. It's possible to write a whole book on Second life, and indeed many have. Its longevity means that there's more study of business uses of such systems than in any other platform.

#### **7.11.2.2 Mozilla Hubs**

Hubs is a great option for this proposal, and might be worth integrating later. It runs well in a browser and on VR hardware.

- Open source, bigger scale, more complex
- Choose avatars, or import your own
- Environments are provided, or can be designed
- Useful for larger conferences with hundreds or thousands of members but is commensurately more complex
- Quest and PC
- Larger scenes within scenes

### 7.11.2.3 Counter social realms

A relatively new platform linked to a new model of social media which excludes countries which habitually spam. It uses Mozilla Hubs for it's engine.

### 7.11.2.4 Roblox

If anything can currently claim to be the metaverse it's probably Roblox. Around 60 billion messages are sent daily in Roblox. Investment in the metaverse 'angle' of the platform is stepping up with recent announcements such as "Spotify Island". It's very notable that it still hasn't become a profitable business. It is important to note that Roblox has banned NFTs. Nike have garnered significant attention for their metaverse store, front with their Roblox based metaverse. As Theo Priestley points out this is likely just another expensive experiment, with a finite lifespan.

### 7.11.2.5 Minecraft

Minecraft has also banned NFTs

### 7.11.2.6 Surreal

### 7.11.2.7 Sansar

### 7.11.2.8 Cornerstone

### 7.11.2.9 AltSpace

- Microsoft social meeting platform
- Very good custom avatar design
- Great world building editor in the engine
- Doesn't really support business integration so it's a bit out of scope
- Huge numbers (many thousands) possible so it's great for global events
- Mac support

### 7.11.2.10 VRChat

This text is from wikipedia and will be updated when we have a chance to try VRChat properly. It's much loved already by the Bitcoin community.

"VRChat's gameplay is similar to that of games such as Second Life and Habbo Hotel. Players can create their own instanced worlds in which they can interact with each other through virtual avatars. A software development kit for Unity released alongside the game gives

players the ability to create or import character models to be used in the platform, as well as build their own worlds.

Player models are capable of supporting "audio lip sync, eye tracking and blinking, and complete range of motion.

VRChat is also capable of running in "desktop mode" without a VR headset, which is controlled using either a mouse and keyboard, or a gamepad. Some content has limitations in desktop mode, such as the inability to freely move an avatar's limbs, or perform interactions that require more than one hand.

In 2020, a new visual programming language was introduced known as "Udon", which uses a node graph system. While still considered alpha software, it became usable on publicly-accessible worlds beginning in April 2020. A third-party compiler known as "UdonSharp" was developed to allow world scripts to be written in C sharp."

#### **7.11.2.11 Meta Horizon Worlds & Workrooms**

Horizon Worlds is the Meta (Facebook) metaverse, and Workrooms it's business offering and a subset of the "Worlds" global system. It is currently a walled garden without connection to the outside digital world, and arguably not therefore a metaverse.

The Financial Times took a look at their patent applications and noted that the travel is toward increased user behaviour tracking, and targeted advertising.

Facebook actually have a poor history on innovation and diversification of their business model. This model has previously been tracking users to target ads on their platform, while increasing and maintaining attention using machine learning algorithms.

It makes complete sense then to analyse the move by Meta into 3D social spaces as an attempt to front run the technology using their huge investment capacity. Facebook have recently taken a huge hit to their share price. Nothing seems to have changed in the underling business except Zuckerberg's well publicised shift to supporting a money losing gamble on the Metaverse. It is by no means clear that users want this, that Meta will be able to better target ads on this new platform, or that the markets are willing to trust Zuckerberg on this proactive move.

With all this said the investment and management capacity and capability at Meta cannot be dismissed. It is very likely that Meta will be able to rapidly deploy a 3D social space, and that it's development will continue to be strong for years. The main interface for Horizon Worlds is through the Meta owned and developer Oculus headset, which is excellent and reasonably affordable. It has been quite poorly received

by reviewers but will likely improve, especially if users are encouraged to innovate.

### 7.11.2.12 Webaverse

Webaverse are an open collective using open source tools to create interoperable metaverses.

### 7.11.2.13 Vircadia

The applications and platforms detailed above have their benefits, but for the application stack in the next section of the book Vircadia has been chosen. The following text is from their website, and is a placeholder which gives some idea. This section will be written out completely to reflect our use of the product.

Vircadia is open-source software which enables you to create and share virtual worlds as virtual reality (VR) and desktop experiences. You can create and host your own virtual world, explore other worlds, meet and connect with other users, attend or host live VR events, and much more.

The Vircadia metaverse provides built-in social features, including avatar interactions, spatialized audio, and interactive physics. Additionally, you have the ability to import any 3D object into your virtual environment. No matter where you go in Vircadia, you will always be able to interact with your environment, engage with your friends, and listen to conversations just like you would in real life.

What can I do? You have the power to shape your VR experience in Vircadia.

- EXPLORE by hopping between domains in the metaverse, attend events, and check out what others are up to!
- CREATE personal experiences by building avatars, domains, tablet apps, and more for you and others to enjoy.
- SCRIPT and express your creativity by applying advanced scripting concepts to entities and avatars in the metaverse.
- HOST and make immersive experiences to educate, entertain, and connect with your audience.
- CONTRIBUTE to the project's endeavor.
- DEVELOP the project and tailor it to your needs, or just to help out.
- SECURITY information about the project and its components.

### 7.11.3 More like crypto NFT virtual land

This next three are a placeholder taking text from the linked site and will be swapped out: The digital land narrative is fading.

#### 7.11.3.1 Decentraland

Decentraland is the first-ever blockchain-powered place in the metaverse. It is a virtual reality platform powered by the Ethereum blockchain. It allows users to create, experience, and monetize content and applications.

#### 7.11.3.2 Sandbox

The Sandbox is a virtual Metaverse where players can play, build, own, and monetize their virtual experiences. The Sandbox blockchain gaming platform consists of three integrated products that together provide a comprehensive experience for user-generated content.

#### 7.11.3.3 Space Somnium

Somnium Space is a metaverse with a different objective. It allows users to join in either through a downloadable VR client or a browser-based version to function like any other web app.

### 7.11.4 More like industrial application

As the word metaverse has gained in use, so have some traditional users and researchers in mixed reality switched to use of the term. Siyaev and Jo describe an aircraft training metaverse which incorporates ML based speech recognition [322]. This class of mixed reality trainer traditionally finds positive results, but is highly task specific.

#### 7.11.4.1 Global enterprise perspective

Microsoft have just bought Activision / Blizzard for around seventy billion dollars. This has been communicated by Microsoft executives as a “Metaverse play”, leveraging their internal game item markets, and their massive multiplayer game worlds to build toward a closed metaverse experience like the one Meta is planning. This builds on the success of early experiments like the Fortnite based music concerts, which attracted millions of concurrent users to live events.

There are three emerging focuses, the social metaverses for pleasure, and business metaverses for larger group meetings and training [323, 324], and a Nvidia’s evolving collaborative creation metaverse for digital engineers and creatives. They’re all pretty different ‘classes’ of

problem. The social metaverse angle where Facebook is concentrating most effort is of less interest to us here, though obviously markets will exist in such systems for business to customer. The next section will explore some of the software tools available to connect people. Everything looks pretty basic right now in all the available systems, but that will likely change over the next couple of years.

## 7.11.5 More like meeting support

### 7.11.5.1 Spatial

Spatial is worth a quick look because it's a business first meeting tool, and comparatively well received by industry for that purpose.

- Very compelling. Wins at wow.
- Great avatars, user generated
- AR first design
- Limited scenes
- Smaller groups (12?)
- Limited headset support
- Intuitive meeting support tools
- No back end integration

### 7.11.5.2 MeetinVR

- Good enough graphics, pretty mature system
- OK indicative avatars, user selected
- VR first design
- Limited scenes
- Smaller groups (12?)
- Quest and PC
- Writing and gestures supported
- Some basic enterprise tools integration
- Bring in 3D objects
- Need to apply for a license?

### 7.11.5.3 Glue

- Better enterprise security integration
- Larger environments, potential for breakouts in the same space.  
Workshop capable
- 3D object support, screen sharing, some collaborative tools
- Apply for a license
- Fairly basic graphics
- Basic avatars

- Quest and PC
- Writing and gestures supported
- Mac support

#### 7.11.5.4 FramesVR

- Really simple to join
- Basic avatars
- Bit buggy
- 3D object support, screen sharing, some collaborative tools
- Quest and PC
- Larger scenes within scenes
- Runs in the browser

#### 7.11.5.5 Engage

- Great polished graphics
- Fully customisable avatars
- Limited scenes
- Presentation to groups for education and learning
- PC first, quest is side loadable but that's a technical issue
- BigScreen VR
- Seated in observation points in a defined shared theatre
- Screen sharing virtual communal screen watching, aimed at gamers, film watching
- up to 12 user

#### 7.11.5.6 Gather

Gather is an oddball meeting space based around fully customisable 2D rooms with a game feel. It's really a spatialised twist on video conferencing but interesting.

#### 7.11.5.7 NEOSVR

Notable because it's trying to integrate crypto marketplaces, but we haven't tried it yet.

## 7.12 Unreal & Virtual Production

Matthew Ball is an expert on Metaverse. He explained his vision and concerns with regard to metaverse in an adaptation of his book[325] featured on Time Magazine (Figure 7.7).

He talks about Epic's Unreal engine and identifies what he calls the Epic Flywheel for games manufacture seen in Figure 7.8.



Figure 7.7: Time magazine Metaverse Cover 2022

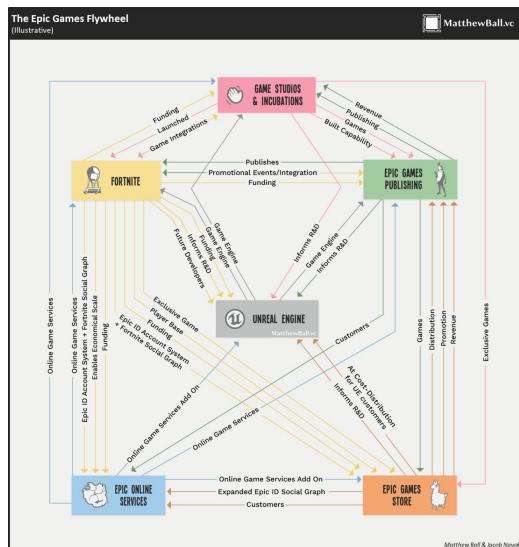


Figure 7.8: Epic games flywheel by Matthew Ball

Epic is a behemoth and has made better business development decisions, and have a better technology than their main competitor Unity3D. Unity didn't make the cut for this book, though their technology is great. Their recent merger with a malware manufacturer and a history of poor data privacy have removed them from consideration at this time.

### 7.12.1 Virtual Production

ICVFX (in camera virtual effects) or “Volume shooting” is the application of large, bright LED walls to film and TV production. More broadly than this Virtual Production is a suite of real-time technologies that weaves through pre and post production to accelerate creativity, and reduce costs. These are collaborative, and often distributed tasks:

- Set ideation and design
- Dry runs with actors to plan shots in mixed reality
- Virtual set design and storyboarding in full VR
- Lighting design
- Shot camera track design (movement, focus, lens choices etc)

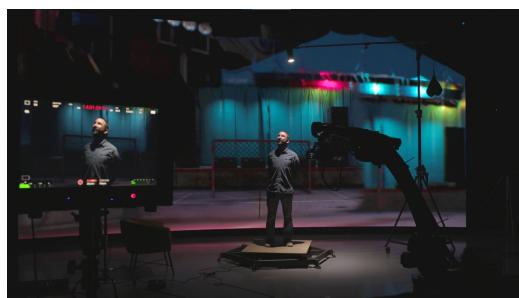


Figure 7.9: John O'Hare (author) with a virtualproduction robot at PathwatXR.

## 7.13 Different modalities

### 7.13.1 Mixed reality as a metaverse

Spatial anchors allow digital objects to be overlaid persistently in the real world. With a global ‘shared truth’ of such objects a different kind of metaverse can arise. One such example is the forthcoming AVVYLAND.

Peleton as a metaverse?

### 7.13.2 Augmented reality

Marc Petit, general manager of Epic Games envisages a 2 watt pair of glasses, connected to a 10 watt phone, connected to a 100 watt computer on the edge. This is a device cascade problem which has not yet been solved, and is at the edge of achievable thermodynamics and latency.

The closest technology at this time seems to be Lumus' waveguide projectors which are light, bright and high resolution.

### 7.13.3 Ubiquitous displays

This includes laser retinal displays, and smart screens which are context and user aware.

## 7.14 Risks

Metaverse is fraught with risks, partly because it's new, and partly because of the pace of adoption. Regulation is well behind the technology, to the alarm of some academic observers [326].

- Abuse; because of the real-time and spatio-temporal abuse happens less like in the current web 2 social media, and more like in the real world, but with less opportunity for repercussions. It might be that natural language processing and machine learning can help with this, but it's a tough problem. One idea might be to record the speech to text of interactions between participants, and flag to them if a “bullying, harassment, predation threshold” is met. This could be encrypted with the public keys of the participants and a notice sent to them that if they wished to follow up with authorities then they have the necessary attestations and proofs. This is minimally invasive and privacy preserving, and acts as a strong disincentive to repeat offence. It can also feed into a global “web of trust” reputation system in a ‘zero knowledge’ way. Users who flag abuse to the reputation system can leverage the machine learning opinion without revealing what happened (though they would have the data). This would also act as a disincentive without the social stigma issues of reporting. Reporting could be achieved without machine learning identification of potential problems, but there would have to be a social cost to reporting (like gossiping incessantly about others) which

would erode the social score of the reporting entity. This would mitigate bot based reputation harm.

- Miscommunication; which as we have seen in the early section of the metaverse chapter is both complex and hard to mitigate
- Lost information
- Distraction
- Jitter, judder, jagginess, and interruption of flow; because the network overhead is higher than other communication media it's much more exposed to latency effects
- Physical harms, especially to developing brains and ocular systems

The UK is positioning itself to heavily regulate safeguarding in the space, with significant fines for non-compliance. This will of course simply lead to users operating on platforms which are not subject to UK law.

some links on consumer protection



## 8. AI and ML features

### 8.1 Augmented intelligence and ML

#### 8.1.1 The Cambrian explosion of ML/AI

Even during the writing of this book there has been an inflection point in machine learning, to the point where the term “artificial intelligence” is feeling intuitively and subjectively real for the first time. To be clear AI is still a pretty meaningless term. ‘Intelligence’ is one of those slippery words which is highly dependent on context. A satnav system running on a phone can make an intelligent choice about a route by synthesising data and presenting comprehensible results, but it seems absurd to ascribe an intelligence to it. To set the tone here let’s have OpenAI’s ChatGPT give us a definition: *Intelligence is the ability to acquire and apply knowledge and skills in order to solve problems and adapt to new situations. It can involve a range of cognitive abilities, such as perception, learning, memory, reasoning, and decision-making. Intelligence is a complex and multifaceted concept that has been studied by psychologists, philosophers, and scientists for centuries.*

The Oxford English Dictionary defines Artificial intelligence as “The capacity of computers or other machines to exhibit or simulate intelligent behaviour”. This is very murky territory. The boundary line between very capable trained systems and something that *feels* like

intelligence is obviously a subjective one, and different for each person and context. We will use AI and ML interchangeably in this text, but is so doing we hope to draw attention to the moment we find ourselves in. It feels like there is an inflection point in human history happening right now. There is now a feedback loop where the data that these systems are trained on will be learning from both human **and** outputs from such systems. Today's young children will never know a world in which the information they encounter is verifiable as of purely human origin. The implications of this are unclear but exciting. In writing this book it became obvious to add this chapter in, and change the direction on the research and product development, because nothing in human history will remain untouched by this. As we will see 'metaverse' is likely to change at an incredible rate as a function of some parts of this technology.

### **8.1.1.1 Ethics**

AI ethics is now a hot topic even outside of the academic fields which have previously wrestled with these issues.

In the field of natural language processing, there have been significant advancements in the use of language models for various tasks. These models are trained on large amounts of text data and are able to generate coherent sentences or paragraphs. They have been used for tasks such as language translation, text summarization, and sentiment analysis. GPT3 and soon GPT4 are the most widely known examples, and are right in the boundary space where ML begins to look like AI. As an example the following was fed into ChatGPT: "write a poem in iambic pentameter about the difficulty humans have deciding if a thing is really intelligent."

The resulting output is termed "one-shot". The first thing that came out, within 3 seconds.

*"Is it true intelligence, or just a guise? We struggle to decide with troubled brow For machines can mimic, with clever guise The way we think and work, with nimble now But do they truly understand and feel? Or is it just a programmed façade? We ponder on this question, with a zeal For understanding if intelligence is a nod To mere programming, or something more profound A spark of consciousness, a self-aware mind These questions plague us, yet we are not bound By any one answer, we are free to find Our own conclusion, as we ponder and muse On the true nature of intelligence and its use".* Note here that this model was trained on orders of magnitude less than then new forthcoming model as shown in Figure 8.1. We suddenly live in very interesting times.

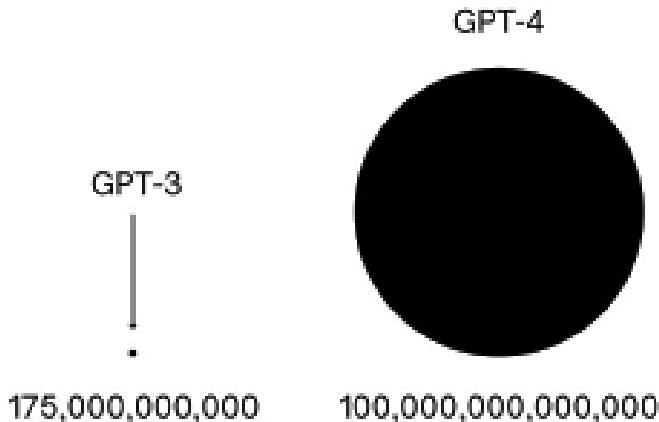


Figure 8.1: The OpenAI GPT4 data corpus is the last ever snapshot of truly human creativity. It was gathered before the data obfuscation introduced by GPT3.

In the sphere of military, geopolitical, and civil defence the application of these tools is both shadowy and seemingly somewhat incompetent. It is an especially twisted irony that ‘Rebellion Defence’ seem to have modelled themselves on the rebellion movement in the Star Wars fictional universe, seemingly unaware that Lucas most likely saw the USA as analogous to the Empire in the films [327]. A recent report from “Stop Killer Robots” identifies the governance concerns which they have been monitoring for years. They identify areas of specific concern.

- transparency and explainability
- responsibility and accountability
- bias and discrimination.

It is beyond the scope of this book to dig far into these issues, but they have serious implications for anyone working in the space.

### 8.1.1.2 The players, the politics, and our choices

The previously mentioned OpenAI is not open. They publish much open source material, but their investment is chiefly from microsoft.

There are some huge players in the field. Nvidia, Microsoft, Amazon, Facebook, and many others are heavily invested, and will expect returns at some point. Figuring out how all this pans out is important and urgent.

### **8.1.2 Whistlestop tour of terms**

#### **8.1.2.1 Transformers**

An important advancement in machine learning is the development of transformers, which are neural network architectures that are capable of processing sequential data. They have been successful in a variety of tasks, including natural language processing, machine translation, and image recognition.

Generative adversarial networks (GANs) are used for generating synthetic data. GANs consist of two neural networks that are trained to compete with each other, with one network generating synthetic data and the other trying to distinguish between the synthetic data and real data. This process allows GANs to learn the underlying distribution of the data and generate samples that are highly realistic.

Reinforcement learning is a type of machine learning that involves an agent learning through trial and error in order to maximize a reward. One example of this is the development of AlphaGo, a machine learning system that was able to defeat a human champion at the board game Go.

#### **8.1.2.2 TPUs**

Tensor Processing Units (TPUs) are specialized hardware accelerators for machine learning workloads, developed by Google. TPUs are designed to speed up the training and inference of machine learning models, particularly large deep neural networks. They are highly parallel and optimized for low-precision arithmetic, which allows them to perform computations much faster than traditional CPUs or GPUs. TPUs can be used in a variety of machine learning applications, such as natural language processing, computer vision, and speech recognition. Google has integrated TPUs into its cloud platform, allowing developers to easily use them for their machine learning workloads. Overall, TPUs provide a powerful and efficient platform for machine learning. The top of the line Nvidia tensorflow unit at this time is [the A100](#), and it is comparable if more generalised hardware.

### 8.1.2.3 Tensorflow

TensorFlow is a popular open-source machine learning framework developed by Google and was instrumental in kicking off a lot of this research area. It is still widely used for training and deploying machine learning models in a variety of applications, such as natural language processing, computer vision, and speech recognition, but is being somewhat superceded by JAX. The consensus seems to be that JAX itself is more specialised and harder to use, but works well with Googles hardware cloud systems. Time will tell if this upgrade gets community traction. TensorFlow provides a flexible and high-performance platform for building and deploying machine learning models. It allows users to define, train, and evaluate models using a variety of deep learning algorithms, such as convolutional neural networks and recurrent neural networks. TensorFlow also has a strong emphasis on scalability and performance, with support for distributed training and deployment on a variety of platforms, including GPUs and TPUs. Overall, TensorFlow is a powerful tool for building and deploying machine learning models.

### 8.1.2.4 PyTorch

PyTorch is a popular open-source machine learning framework developed by Facebook's AI research group. It is primarily used for applications such as natural language processing and computer vision. PyTorch is based on the Torch library and provides two high-level features: tensor computations with strong GPU acceleration and deep neural networks built on a tape-based autograd system. PyTorch offers a variety of tools and libraries for machine learning, including support for computer vision, natural language processing, and generative models. It also allows for easy and seamless interaction with the rest of the Python ecosystem, including popular data science and machine learning libraries such as NumPy and scikit-learn.

### 8.1.2.5 NumPy

NumPy is a popular open-source library for scientific computing in Python. It provides a high-performance multidimensional array object, as well as tools for working with these arrays. NumPy's array class is called ndarray, which is a flexible container for large datasets that can be processed efficiently. The library provides a wide range of mathematical functions that can operate on these arrays, including linear algebra operations, Fourier transforms, and random number generation. NumPy also has a powerful mechanism for integrating C,

C++, and Fortran code, which allows it to be used for high-performance scientific computing in a variety of applications. Overall, NumPy is an essential library for working with numerical data in Python.

### **8.1.2.6 Latent space**

In the context of generative artificial intelligence (AI), a latent space is a high-dimensional space in which the model represents data as points. This space is "latent" because it is not directly observed, but is inferred by the model based on the data it is trained on. In the case of a generative model, the latent space is often used to encode the underlying structure of the data, such that samples can be generated by sampling from the latent space and then decoding them into the data space.

For example, in a generative model for images, the latent space may encode the features or characteristics of the image, such as the shape, color, and texture. By sampling from this latent space and decoding the sample, the model can generate new images that are similar to the training data, but are not exact copies. This allows the model to generate novel and diverse samples that capture the essence of the training data.

The latent space is an important aspect of generative models because it allows the model to capture the underlying structure of the data in a compact and efficient way. It also provides a way to control the generation process, such as by interpolating between latent space points to generate smooth transitions between samples. At this time the navigation through that mathematical space is steered by vectors into the space, which come from a separate and parallel integration of a natural language model. This crucial bridge came from research at OpenAI, and has been instrumental in the current explosion of usability of the systems [328].

## **8.1.3 Consumer tools**

### **8.1.3.1 RunwayML**

Runway is VFX software in the cloud, trained with Stable Diffusion machine learning. They are demonstrating incredible results for video editing.

### **8.1.3.2 ChatGPT**

ChatGPT is a neural network-based natural language processing (NLP) model developed by OpenAI. It is based on the GPT-3, being described

as OpenAI's version 3.5 model, which is a transformer-based architecture that uses self-attention mechanisms to generate high-quality text in a variety of different languages. ChatGPT is specifically designed for conversational text generation, and has been trained on a large corpus of dialogue data in order to produce responses that are natural, diverse, and relevant to a given conversation. Because it is a large language model, ChatGPT has a vast amount of knowledge and can generate responses to a wide range of questions and prompts. This allows it to generate responses that are relevant, natural-sounding, and diverse in nature. It has been incredibly popular recently, demonstrating uncanny abilities for natural conversation, code generation, copy writing and more. It is substantially flawed in that it 'speaks' with authority but often makes things up completely. This extended recently to creating academic references to back its assertions, completely out of thin air. The beta interface and APIs seem to be evolving and improving in real time.

The model uses a transformer-based architecture, which means that it consists of a series of interconnected "blocks" that process the input data and generate the output text. Each block contains multiple self-attention mechanisms, which allow the model to focus on different aspects of the input data and generate a response that is coherent and relevant to the conversation. In addition to its transformer-based architecture, ChatGPT also uses a variety of other techniques to improve its performance. For example, it uses beam search to generate multiple candidate responses for each input, and then selects the best one based on a combination of factors such as relevance, coherence, and diversity. This allows the model to generate high-quality responses that are appropriate for a given conversation. Additionally, ChatGPT uses a technique called "response conditioning" to bias the model towards generating responses that are appropriate for a given conversation context. This allows the model to generate more relevant and coherent responses, even when faced with challenging input data.

## **8.1.4 Accessibility**

### **8.1.4.1 Real time transcription**

Real-time language translation can be applied to text interfaces within metaverse applications. This can be useful in situations where users are typing or reading text, rather than speaking.

To apply NMT to text interfaces in the metaverse, the algorithm can be integrated into the interface itself. When a user types text in

a specific language, the NMT algorithm can automatically detect the language and generate a translation in the desired language. This can be done in real-time, allowing for fast and seamless communication between users speaking different languages. NMT algorithms are well-suited for use in text interfaces, allowing for fast and accurate translations between multiple languages. As the technology continues to advance, we can expect to see more and more applications of NMT in the metaverse.

#### **8.1.4.2 Real time translation**

One of its most impressive recent applications is real-time language translation. In this section we will explore how this technology works, and how it can be used in metaverse applications.

Real-time language translation refers to the ability of a machine learning model to instantly translate spoken or written text from one language to another. This is different from traditional translation methods, which often involve human translators and can be slow and error-prone.

One of the key technologies behind real-time language translation is neural machine translation (NMT). This is a type of machine learning algorithm that is based on neural networks. NMT algorithms are trained on large datasets of text that has been translated by human experts. This allows the algorithm to learn the patterns and nuances of each language, which it can then use to generate accurate translations.

One of the key references for the use of neural machine translation in real-time language translation is the paper "Neural Machine Translation by Jointly Learning to Align and Translate" by Bahdanau et al [329]. This paper describes the use of a neural network-based approach to machine translation, which has shown impressive results in terms of accuracy and speed.

One of the key advantages of NMT is its ability to handle complex and varied sentences. Traditional translation algorithms often rely on fixed rules and dictionaries, which can be limiting. NMT algorithms, on the other hand, can learn to handle a wide range of sentence structures and vocabulary. This makes them well-suited for translating natural languages, which are often full of irregularities and exceptions.

Another advantage of NMT is its ability to handle multiple languages at once. Traditional translation algorithms often require the user to specify the source and target languages, but NMT algorithms can automatically detect the languages of the input and output text. This makes them well-suited for use in metaverse applications, where users may be speaking different languages at the same time.

One of the challenges of using NMT in metaverse applications is the need for real-time performance. Metaverse applications often involve fast-paced interactions, and any delay in language translation can hinder the user experience. To overcome this challenge, NMT algorithms can be optimized for speed, using techniques such as parallel processing and batching. It seems likely that in our proposed systems we will require API calls to external services for this functionality, and this will almost certainly incur a cost.

The use of NMT in metaverse applications is also an active area of research, with a number of papers exploring the potential of this technology. For example, the paper "Real-Time Neural Machine Translation for Virtual Reality" by Chen et al. describes the use of NMT algorithms in virtual reality environments, showing how they can be used to support real-time communication between users speaking different languages.

Overall, the use of machine learning for real-time language translation is a rapidly-evolving field, with many exciting developments and applications. As the technology continues to advance, we can expect to see even more impressive results and applications in the future. OpenAI whisper

#### **8.1.4.3 Real time description**

#### **8.1.4.4 Interfaces**

emg

#### **8.1.4.5 Text to sound**

Complex acoustic environments are possible using text to sound prompting.

### **8.1.5 Virtual humans**

#### **8.1.5.1 Real time human to avatar mapping**

### **8.1.6 AI actors**

#### **8.1.6.1 Faces**

#### **8.1.6.2 Voices**

#### **8.1.6.3 Dreambooth**

#### **8.1.6.4 Autonomous tasks**

Extrinsic AI actors which link multiple intrinsic virtual spaces.

Bespoke news and current affairs synthesis  
Bespoke interactive subject matter training  
bots that bring you what you want as bespoke audio visual packages

### **8.1.7 Governance and safeguarding**

#### **8.1.7.1 Governance in the Virtual Reality Space**

The governance of the virtual world will be a critical element in the success of the Metaverse. The virtual world will need to be policed and governed in a way that will not only protect the rights of the citizens of this new digital environment but also protect them from cybercrime. Governments and regulatory bodies will play a key role in the governance of the virtual world, but so will the industry and businesses. Nair et al describe the “unprecedented privacy risks” of the metaverse, finding that wearing a headset can currently reveal 25 data points about the user, simply by analysis of the data [330]. This included inference about ethnicity, disability, and economic status. Strong data protection laws will be needed to safeguard privacy, data ownership and reduce the risk of data breaches. The governance of the virtual world will be critical to success, safeguarding will be needed to protect citizens from cyberattacks.

#### **8.1.7.2 Safeguarding in the Metaverse**

When it comes to safeguarding in the Metaverse, people need to be made aware of the risk of using VR technology. There are still many questions around the health implications of using VR and the impact it may have on a person’s eyesight. In terms of safeguarding in the Metaverse, this is just one area that needs to be addressed. Users will also need to be made aware of the risks of hacking. Users will need to be educated on the need to be careful when it comes to sharing personal information and be careful what websites they access on a virtual computer. They will need to be made aware of the potential risk of having malware installed on their computer by visiting untrusted websites. Users will also need to be made aware of the potential risk of being manipulated in the virtual world. This risk is particularly high when it comes to children who are growing up in the digital world. They will need to be educated on the potential risks of being groomed or manipulated in the Metaverse.

### **8.1.7.3 How to fight against cybercrime in the Metaverse?**

The best way to fight against cybercrime in the Metaverse is to educate the general public on the potential risks and dangers in order to prevent them from being targeted. This can be done through various channels and mediums, such as social media, blogs and podcasts. People will need to be made aware of the risks of opening emails or clicking on links sent by unknown people. They will also need to be aware of the risks of clicking on ads and links that may lead them to websites that host malware or that steal personal information.

AI bill of rights

Roblox in BBC news for child exploitation.





## 9. Our proposition

This chapter identifies an intersectional space across the described technologies, and proposes a valuable and novel software stack, which can enable exploration and product development. It is useful to briefly look at some of the potential applications which might benefit from value and trust exchange within a global shared social space.

### 9.1 Summary TL;DR

- There may be an inflection point in the organisational topology of the internet, because of trust abuses by the incumbent providers. This moment has been calling itself Web3, but the moniker is fraught with problems, and somewhat meaningless. The drivers are real.
- ‘The Metaverse’ is coming, in some form, at some point. Everyone is positioning in case it’s “soon”. It’s not at all clear what it is, or if people want it, but the best of the emergent narrative looks like the older field of “digital society” and that obviously should not be dismissed lightly.
- Large scale ‘social’ & immersive metaverse is suffering poor adoption, failing as it has in the past. It’s likely that the market need has been overstated. More advanced and popular (closed) games based solutions do not serve societal or business needs.

- From a business perspective metaverse is the worst of the remote collaboration tool-kits, and undermines flow, productivity, and interpersonal trust. Metaverse is probably technology for technologies sake at this time, but the investment is real. Digital society is more tangible and less hyped, and extends out into the more compelling spatial and augmented reality technologies.
- Emerging markets, the global south, indeed much of the world is excluded from many of the tools that are taken for granted in ‘Western’ digital society. They do not necessarily have the identification, banking rails, or compute power to engage fully.
- Excluding Facebook/Meta, a lot of the investment is coming from the recent Web3 speculative bubble. They have a parallel and intersectional metaverse narrative, based around distributed financial tooling and digital assets.
- There is genuine, undeniable interest in digital scarcity. The ownership of digital goods seems natural to younger, digitally native users. This is serviced already by various (gaming) platforms, but they are all isolated ecosystems.
- Uniting these attempts, with portable (transferable) “goods” across digital society likely requires a global ledger (blockchain), indeed this is the basis of the Web3 interpretation. Crypto is igniting imagination on this topic, and is seeing adoption both inside and outside of the metaverse context. There are other potential options available soon.
- Crypto is a nightmare; rife with scams, poor technology choices, limited life, and incorrect assumptions. The only thing blockchain / crypto can do well is “money like networks”, which is a cornerstone of human interaction, and the killer application.
- Representations of dollars and pounds can ride securely on top of such networks as stablecoins, and this is getting easier to integrate, though there are risks. This has the potential to open up global collaborative working practices, inclusive of emerging markets.
- It’s unclear which technology will win, if any, but since the tools exist now they can be integrated and tested immediately. Money, digital asset, identity, and thereby trust, can already be mediated by the Bitcoin network, even without using Bitcoin the asset. This is an opportunity.
- Legislative and cultural headwinds are significant. There might be no opportunity here in the end, though “rough game theory” supports the attempt.

- Industry has noted the risk, and failures of Meta across both metaverse, and digital currency, and have latched onto "open metaverse" as a narrative, to de-risk their interest. The current open metaverse is muddy and confused.
- A truth seems to have been missed; that open metaverse should mean open source metaverse. There are some options, but they are under developed. We would like to contribute to this by applying our decades of tele collaboration research.
- The UK seems to be endorsing significant controls and restrictions on internet usage including metaverse applications. This compliance overhead will price small companies out of large scale social experiences. Company walled gardens are less impacted (as per the slack service model), and this is an opportunity if tied to real business use cases.
- Anything from a multi-million pound XR studio screen, to a speech audio system, can be a digital society interface.
- AI & machine learning and especially 'generative art' is further blurring these boundaries. A better term for AI/ML is 'supported creativity' and/or 'augmented intelligence'.
- Trust, accessibility, governance, and safeguarding, are hard problems, and made more complex by unrecorded social flow in immersive social VR.
- A topologically flat, inclusive, permissionless, open metaverse, with economically empowered ML and AI actors, which can mediate governance issues, transparently, according to well constructed custom schemas, between cryptographically verifiable economic users (human or AI) is an opportunity.
- New open source [supported creativity, augmented intelligence] tooling from StabilityAI potentially removes many of the problems with accessibility, creativity, language barriers, safeguarding, and governance. This is a huge, complex, and fast moving area, but tremendously exciting.
- Using new image generation ML it may be possible to build new kind of collaborative global networks for virtual production, ideating in simplistic immersive spaces while instantly creating demonstrable in camera scenes which can be stylised using verbal commands in real-time. This may open up and enfranchise fresh ideas from a wider cultural pool.
- Such teams could be far more ad-hoc by experimenting with the designs outlined in this book. This kind of genuine digital society use case is something sorely lacking in large scale

attempts such as Meta Horizons. It need not be complex or large scale, but it must be secure, trusted, and task appropriate. We think we can deliver this and conversations with the industry suggest that there is excitement and cautious appetite.

## 9.2 Software stack

This section needs building out to describe the stack and the choices made, but can be seen in Figure 9.1 and Figure 9.2.

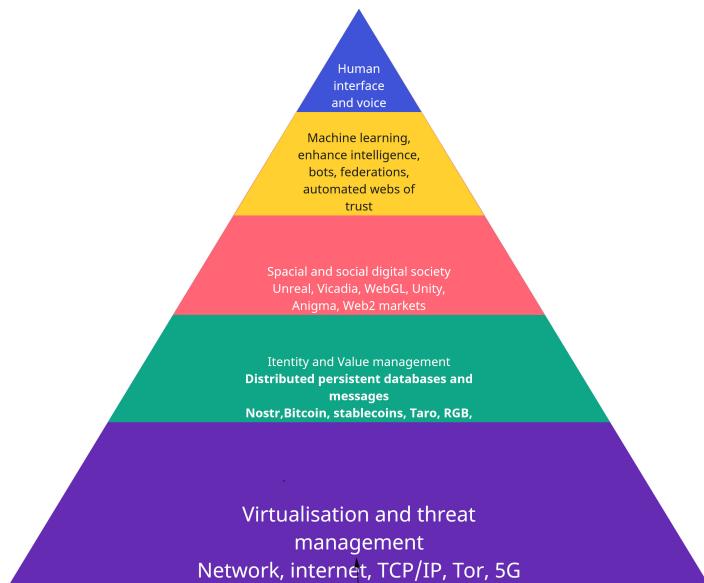


Figure 9.1: Pyramid showing the components for sats, stablecoins on lightning, assets, and trust

## 9.3 Pathway & telepresence

Designing open federated metaverse from a 25 year research foundation There are serious and under discussed natural social constraints on group behaviours, and these translate into social VR. For instance the ideal meeting size is 6, and this is naturally established in work settings. This has not translated into a metaverse setting where dozens

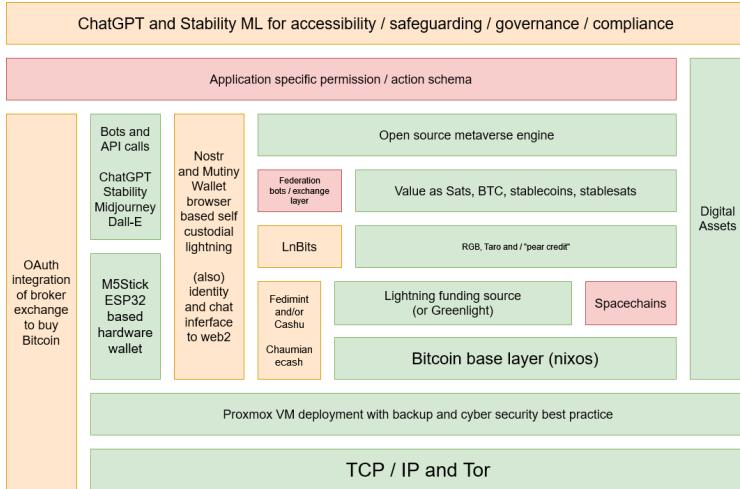


Figure 9.2: High level overview showing the components for sats, stablecoins on lightning, assets, and trust

of people routinely crash across one another. In the context of supporting a creative “backstage” world where set planning, production shots, etc can be discussed we believe we have solutions which will get the best out of distributed teams of film-makers. Leveraging the world’s most powerful decentralised computing network to create scale and security without high cost The Bitcoin network is more than just a speculative money like asset, it is the most secure distributed computing system ever built. We can jump on the back of this at almost no cost to enable scale for transfer of value, trust, and digital assets of provenance. Cryptographically assured end points With the cryptography tools provided through integration of the Bitcoin network we can also use non-blockchain based secure messaging, and identity proofs. Micro transactions in collaborative spaces New tooling the space allows fractions of a pound or dollar to be exchanged between parties across the world. This means that work can be paid “by the second” both inside and outside of the metaverse. This radically improves creative microtask workflows. World leading open source machine learning and bot architectures By integrating Stability AI tools for image generation, video processing, natural language, and speech to text / text to speech we hope to reduce friction within the backstage worlds. Creating a narrative arrow from a remote director/producer/DP, through

a VP screen into a shoot, and back into a persistent metaverse shared with the public. By linking across these new systems with world class telepresence research we hope to use a single digital context to support senior stakeholders, creatives, technical teams, and the wider public. New paths to monetisation and digital ownership. This unified digital back end is optimised for flows of money, trust, and digital objects. This is a new area for VP. Current workstreams:

- Storyboarding with text2img and dreambooth to add talent and costume ideas before meeting up, as demonstrated in this document [331].
- Collaborative, self hosted, high speed, low detail, economically and cryptographically enabled set design spaces, with near instant language translation (speech to text and speech to speech). Micropayment for cheap international labour. Technology agnostic. Use the screen, audio only, compressed video dial-in, headsets, tablet rendering: (this book).
- High end telepresence [253, 332, 333, 334] into the studio/shoot from the virtual set, allowing high value stakeholders to be ‘present’ on set as virtual collaborators with spatial discrimination allowing directional queues. This involved real time human capture like moveAI or the expensive rigs with DSLRs.
- Novel render pipeline for fast turnaround of final look and feel, taking the rough scene and applying img2img ML with the kind of interframe consistency we are starting to see from the video projects [335].
- Text to model pipeline for interactively building key elements with senior stakeholders, pushed from post ideation to the pre-shoot Unreal content creation [336].
- All assets switch over to Unreal metaverse and become consistent (optimised) digital set which can be visited by stakeholders, funders, VIPs etc. Public can visit later for a fee? Digital assets can be bought from the set.

## **9.4 Novel VP render pipeline**

Putting the ML image generation on the end of a real-time tracked camera render pipeline might remove the need for detail in set building. To describe how this might work, the set designer, DP, director, etc will be able to ideate in a headset based metaverse of the set design, dropping very basic chairs, windows, light sources whatever. There is -no need- then to create a scene in detail. If the interframe consistency

(img2img) can deliver then the output on the VP screen can simply inherit the artistic style from the text prompts, and render production quality from the basic building blocks. Everyone in the set (or just DP/director) could then switch in headset to the final output and ideate (verbally) to create the look and feel (lens, bokeh, light, artistic style etc). This isn't ready yet as the frames need to generate much faster (100x), but it's very likely coming in months not years. This "next level pre-vis" is being trailed by Pathway in the Vircadia collaborative environment described in this book, and can be seen illustrated in Figure 9.3.

This can be done now through the use of camera robots. A scene can be built in basic outline, the camera tracks can be encoded into the robot, and the scene can be rapidly post rendered by Stability with high inter frame consistency.

With the help of AI projects such as LION it may be possible to pass simple geometry and instructions to ML systems which can create complex textured geometry back into the scene.

## 9.5 Money in metaverses

### 9.5.1 ML actors and blockchain based bots

Stablity AI is an open source imitative to bring ML/AL capabilities to the world. This is a hugely exciting emergent area and much more will be developed here.

### 9.5.2 AI economic actors in mixed reality

AI actors can now be trusted visually [337]. We have some thinking on this which links the external web to our proposed metaverse using tooling developed by Melvin Carvelho. He is working on economically empowered bots which leverage Nostr and RGB to perform functions within our metaverse, and outside in the WWW, as well as interacting economically through trusted cryptography with other bots, anywhere, and human participants, anywhere. This is incredibly powerful and is assured by the Bitcoin security model. Imagine being able to interact with a bot flower seller representing all the real world florists it had found. In the metaverse you could handle the flowers and take advice and guidance from the bot agent, then it would be able to take your money to buy you flowers to send to a real world address, and later find you to tell you when it's delivered. These possibilities are endless. The AI chat element, the AI translation of images on websites to 3D

assets in the Metaverse are difficult but possible challenges, but the secure movement of money from the local context in the metaverse to the real world is within reach using these bots, and they are completely autonomous and distributed.

## **9.6 Our socialisation best practice**

### **9.6.0.1 Identity**

We will base our identity and object management on Nostr public/private key pairs. The public key of these enable lightning based exchange of value globally. Additional work will be needed to allow objects generated through RGB to be passed between federated worlds.

### **9.6.0.2 Webs of trust**

Webs of trust will be built within worlds using economically costly (but private) social rating systems, between any actor, human or AI. It should be too costly to attack an individual aggressively. This implies an increased weighting for scores issued in short time periods. Poorly behaving AI's will eventually be excluded through lack of funds.

### **9.6.0.3 Integration of 'good' actor AI entities**

Gratitude practice should be encouraged between AI actors to foster trust and wellbeing in human observers. “It’s nice to be nice” should be incentivised between all parties”. This could include tipping and trust nudging through the social rating system. Great AI behaviour would result in economically powerful entities.

## **9.6.1 Emulation of important social cues**

Classroom layout

### **9.6.1.1 Behaviour incentives, arbitration, and penalties**

Collapses of trust and abuse will trigger flags from ML based oversight, which will create situational records and payloads of involved parties to unlock with their nostr private keys. ML red flagged actors will be financially penalised but have access to human arbitration using their copy of the data blob. Nothing will be stored except by the end users.

## **9.6.2 Federations of webs of trust and economics**

Web2/3 enabled ‘Bitbots’ by Melvin Carvalho, with their own money supply, should be able to carry data payloads between virtual worlds

across all networks. This is an RGB/Nostr/Melbot problem space and requires more investigation.

## 9.7 Security evaluation

As part of developing our stack we will penetration test the deployment as detailed using Hexway

## 9.8 notes for later

Notes on build-out The world database in the shared rooms in the metaverse is the global object master, educational materials, videos, audio content and branded objects are fungible tokens authentically proved by rgb client side validation between parties, only validated ones will be persisted in shared rooms like conferences and classes according to the room schema. That allows educators to monetise their content. That can work on lightning. NFT objects between parties like content crafted by participants (coursework, homework) are not on lightning and will attract main chain fees but are rarer. User authentication and communication will be through nostr.



Figure 9.3: Top panel is a screen grab from Vircadia and the bottom panel is a quick pass through img2img from Stable Diffusion.



Figure 9.4: Robot VP

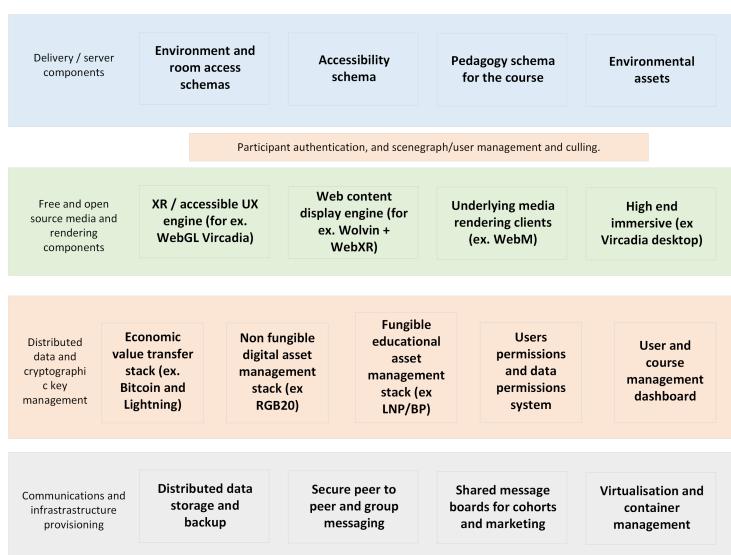


Figure 9.5: Functional elements for infrastructure.

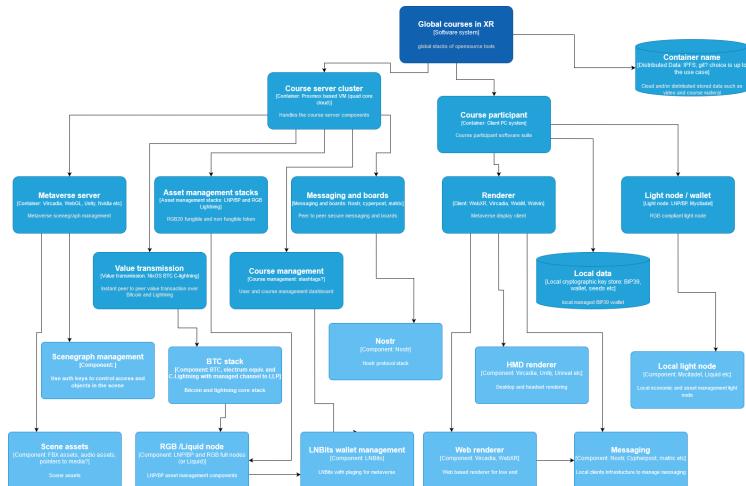


Figure 9.6: Client server C4 diagrams.





## 9.9 Acknowledgements and thanks

As you'd expect lots of work went into checking the book. Special thanks to Melvin Carvalho, Tim Millar, Lorena Gomez, James Lewis, @smallworfnd, and Margaret O'Hare.

## 9.10 Author Biographies

Dr John O'Hare is a results driven, certified Prince2 Agile Practitioner. Leveraging proven analytical ability, and drawing on 23 years of experience at the University of Salford. Successful as a leader and an influential team member in both project and customer-facing roles. As a product manager he specialises in systems design, procurement, tendering and bid writing for research funding, running complex heterogeneous research systems, research and development, and supporting academic staff / research students to undertake theirs. Completed a PhD in "Attention in Telepresence", uniting the gaze of remote collaborators, through furniture. Recently pursuing research opportunities in value transfer mechanisms for 'Metaverses'.



Dr Allen Fairchild is an experienced security-conscious software engineer and academic researcher with comprehensive experience developing innovative end-to-end systems for a wide variety of use-cases. Strong leadership and acumen in full stack development. Track record in building networks through regional initiatives, delivering Agile projects to a wide variety of technical markets. Allen is an accomplished researcher and holds a PhD Video based reconstruction system for mixed reality environments supporting contextualised non-verbal communication and its study, alongside a portfolio of groundbreaking publications in social VR. Excellent communication skills and Agile team leadership.



Dr Umran Ali currently works as a senior lecturer in creative media, and continues to explore virtual natural environment design through teaching and research, maintaining a deep interest in the meaning, impact, and design of natural spaces, in particular around video games. A keen video game collector and player, and a landscape photographer. Holds a PhD in A practice-based exploration of natural environment design in computer & video games.



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