

Working Paper - Digital Coins - Preliminary Survey - The bitcoin as a test case

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Introduction

The increasing popularity of the bitcoin, since its introduction in 2009, and in particular since the start of 2013, has sharpened the need for an in-depth examination of the subject of digital coins - including their possible impact on investors and on the Israeli capital market. On February 2014, Israeli regulators issued a joint notice dealing with digital coins and the dangers presented by their use as well as problems caused by holding, investing and using bitcoins. The warning focused on the dangers resulting from the unclear legal and regulatory status of digital coins; from the fact that they are not legal tender¹ in any country; from the possibility that they can be used for the purpose of money-laundering;² and from other illegal activities for which they are used or which are connected to them. Additionally, the warning referred to further dangers derived from the fluctuations in the value of the coins themselves, the difficulty involved in protecting them from theft, and the instability and limited regulation of websites and trading and conversion services that handle digital coins. At the same time, the topic of digital coins is still in its infancy, in terms of their scope of the use of, in terms of their continued technological development, and in terms of the legal and regulatory treatment of the use of these coins. It is therefore necessary to continue studying the subject in order to develop an understanding of its proper treatment by regulators and those who are regulated, and by the general public as well.

This need is made clearer in light recent trends regarding digital coins. On the one hand, the value of the coins rose sharply in 2013 as did the scope of their usage. The latest estimations are that some 63 thousand businesses throughout the world accept bitcoins as payments for services and products that they provide.³ A large percentage of these businesses even provide conventional Tangible products, such as the large online store Overstock.com, which sells clothes, furniture, electronics and a variety of other products. The computer giant, Dell,⁴ has also begun to accept bitcoin payments and even gives a 10% discount to those who pay with the digital coin. Additionally, three more large companies (with annual incomes of over 2 billion dollars) have started to allow bitcoin purchases: the satellite television company DISH, the Expedia tourism website, and the Newegg retail electronics company. Bitcoins can also be

¹ A currency which is legal tender is a means of payment which may be used to pay for a debt (mostly arising from a purchase or sale transaction) the acceptance of which may not, by law, be refused. Source: Wikipedia.

² Money laundering is financial activity in which the identity of the source is hidden and the money transferred through such activity is missing. In this way, "dirty money" which is money the source of which is tax evasion or criminal activity (such as drug trafficking) is transformed into money which does not give rise to suspicion. Money laundering is considered to be a crime. Source: Wikipedia.

³ <http://www.coindesk.com/state-of-bitcoin-q2-2014-report-expanding-bitcoin-economy/>

⁴ <http://www.coindesk.com/dell-bitcoin-aligns-brand-innovation/>

used to purchase airline tickets from companies such as Cheapair.com⁵ and Air Baltic to pay for the services of attorneys and real estate agents and to purchase a wide variety of other goods and services. It appears that consumers are making use of this new possibility to pay with bitcoins: Overstock and Cheapair announced in July 2014 that they have each sold products with a value of over 1.5 million dollars, paid for with bitcoins.⁶

Nevertheless, it appears that the main interest in the bitcoin is as an investment. This is in light of the very significant increase in its price during the course of 2013. On the first of January 2013 the total value of bitcoins (total bitcoins in circulation times the dollar price of a single bitcoin) was almost 144 million dollars (\$143,848,307), at a price of \$13 per bitcoin. This jumped to a total value of almost 14.5 billion dollars (\$14,464,698,057) at the price of \$1203 per bitcoin on 30 November 2013 - an increase of 1000% in its total value.⁷ On the other hand, during the last three months, the value of a bitcoin fell sharply, and its current value (at 11 May 2014) is \$443.

These significant and contradictory trends clarify the need for a preliminary review of the key aspects involved in the issue of digital coins - a review which this paper will provide.

⁵ <http://www.coindesk.com/airbaltic-waives-controversial-bitcoin-transaction-fee/>

⁶ <http://www.coindesk.com/cheapair-tops-1-5-million-in-total-bitcoin-sales/>

⁷ <https://blockchain.info/charts/market-cap>