

Wild, unregulated hacker currency gains following (Update)

April 11 2013, by Raphael Satter



In this April 3, 2013 photo, Mike Caldwell, a 35-year-old software engineer, holds a 25 Bitcoin token at his shop in Sandy, Utah. Caldwell mints physical versions of bitcoins, cranking out homemade tokens with codes protected by tamper-proof holographic seals, a retro-futuristic kind of prepaid cash. With up to 70,000 transactions each day over the past month, bitcoins have been propelled from the world of Internet oddities to the cusp of mainstream use, a remarkable breakthrough for a currency which made its online debut only four years ago. (AP Photo/Rick Bowmer)

With \$600 stuffed in one pocket and a smartphone tucked in the other, Patricio Fink recently struck the kind of deal that's feeding the rise of a

new kind of money—a virtual currency whose oscillations have pulled geeks and speculators alike through stomach-churning highs and lows.

The Argentine software developer was dealing in bitcoins—getting an injection of the cybercurrency in exchange for a wad of real greenbacks he handed to a pair of Australian tourists in a Buenos Aires Starbucks. The visitors wanted spending money at black market rates without the risk of getting roughed up in one of the Argentine capital's black market exchanges. Fink wanted to pad his electronic wallet.

In the safety of the coffee shop, the tourists transferred Fink their bitcoins through an app on their smartphone and walked away with the cash.

"It's something that is new," said Fink, 24, who described the deal to The Associated Press over Skype. "And it's working."

It's transactions like these—up to 70,000 of them each day over the past month—that have propelled bitcoins from the world of Internet oddities to the cusp of mainstream use, a remarkable breakthrough for a currency that made its online debut only four years ago.

When they first began pinging across the Internet, bitcoins could buy you almost nothing. Now, there's almost nothing that bitcoins can't buy. From hard drugs to hard currency, songs to survival gear, cars to consumer goods, retailers are rushing to welcome the virtual currency whose unofficial symbol is a dollar-like, double-barred B.

Advocates describe Bitcoin as the foundation stone of a Utopian economy: no borders, no change fees, no closing hours, and no one to tell you what you can and can't do with your money.

Just days ago the total value of bitcoins in circulation hit \$2 billion, up

from a tiny fraction of that last year. But late Wednesday, Bitcoin crashed, shedding more than 60 percent of its value in the space of a few hours before recouping some of its losses. Critics say the roller coaster currency movements are just another sign that Bitcoin is a bubble waiting to burst.

Amid all the hype, Bitcoin's origins are a question mark.



In this April 3, 2013 photo, Mike Caldwell, a 35-year-old software engineer, looks over bitcoin tokens at his shop in Sandy, Utah. Caldwell mints physical versions of bitcoins, cranking out homemade tokens with codes protected by tamper-proof holographic seals, a retro-futuristic kind of prepaid cash. With up to 70,000 transactions each day over the past month, bitcoins have been propelled from the world of Internet oddities to the cusp of mainstream use, a remarkable breakthrough for a currency which made its online debut only four years ago. (AP Photo/Rick Bowmer)

The mechanics of the virtual currency were first outlined in a research paper signed by Satoshi Nakamoto—likely a pseudonym—and the coins made their online debut in 2009. How the coins are created, how the transactions are authenticated and how the whole system manages to power forward with no central bank, no financial regulator and a user base of wily hackers all comes down to computing power and savoir faire.

Or, as Nicholas Colas, chief market strategist for the ConvergeX Group, describes it: "genius on so many levels."

The linchpin of the system is a network of "miners"—high-end computer users who supply the Bitcoin network with the processing power needed to maintain a transparent, running tally of all transactions. The tally is one of the most important ways in which the system prevents fraud, and the miners are rewarded for supporting the system with an occasional helping of brand-new bitcoins.

Those bitcoins have become a dangerously hot commodity in the past few days.

Rising from roughly \$13 at the beginning of the year, the price of a single bitcoin blasted through the \$100 barrier last week, according to Mt. Gox, a site where users can swap bitcoins for more traditional currencies.

On Tuesday, the price of a single bitcoin had topped \$200. On Wednesday, it hit \$266 before a flash crash dragged it back down to just over \$100. By Thursday, bitcoins were trading for around \$150.

The rebel currency may seem unstable, but then so do some of its more traditional counterparts. Some say Bitcoin got new momentum after the banking crisis in Cyprus pushed depositors there to find creative ways to

move money. Fink, the Argentine, favors bitcoins because he believes they will insulate him from his country's high inflation. Others—from Iranian musicians to American auto dealers—use the currency to dodge international sanctions or reach new markets.

But the anything-goes nature of Bitcoin has also made it attractive to denizens of the Internet's dark side.

One of the most prominent destinations for bitcoins remains Silk Road, a black market website where drug dealers advertise their wares in a consumer-friendly atmosphere redolent of Amazon or eBay—complete with a shopping cart icon, a five-point rating system and voluminous user reviews. The site uses Tor, an online anonymity network, to mask the location of its servers, while bitcoin payments ensure there's no paper trail.

One British user told the AP he first got interested in Silk Road while he was working in China, where he used the site to order banned books. After moving to Japan, he turned to the site for an occasional high.

"Buying recreational drugs in Japan is difficult, especially if you don't know people from growing up there," said the user, who asked for anonymity because he did not want his connection to Silk Road to be publicly known.

He warned that one of the site's drawbacks is that the drugs can take weeks to arrive "so there's no spontaneity."

Drug dealers aren't the only ones cashing in on Bitcoin. The hackers behind Lulz Security, whose campaign of online havoc drew worldwide attention back in 2011, received thousands of dollars' worth of bitcoins after promising followers that the money would go toward launching attacks against the FBI.

A report apparently drawn up by the bureau and leaked to the Internet last year said that "since Bitcoin does not have a centralized authority, detecting suspicious activity, identifying users and obtaining transaction records is problematic for law enforcement."



In this April 3, 2013 photo, Mike Caldwell, a 35-year-old software engineer, poses with bitcoin tokens at his shop in Sandy, Utah. Caldwell mints physical versions of bitcoins, cranking out homemade tokens with codes protected by tamper-proof holographic seals, a retro-futuristic kind of prepaid cash. With up to 70,000 transactions each day over the past month, bitcoins have been propelled from the world of Internet oddities to the cusp of mainstream use, a remarkable breakthrough for a currency which made its online debut only four years ago. (AP Photo/Rick Bowmer)

It went on to warn that bitcoins might become "an increasingly useful tool for various illegal activities beyond the cyber realm"—including child pornography, trafficking and terrorism.

The FBI did not immediately respond to an email seeking comment.

Late last month, the U.S. Treasury's Financial Crimes Enforcement Network, or FinCen, announced it was extending its money-laundering rules to U.S. bitcoin dealers and transfer services, meaning that companies that trade in the cybercurrency would have to keep more detailed records and report high-value transactions.

Many in the Bitcoin community are frustrated at the attention paid to the shadier side of the virtual economy.

Atlanta-based entrepreneur Anthony Gallippi said the focus on drugs and hacking misses the "much bigger e-commerce use for this that's growing and that's growing rapidly."

Very few businesses set their prices in bitcoins—the currency swings would be too jarring—but an increasing number are accepting it for payment. Gallippi's company, BitPay, handles Bitcoin transactions for some 4,500 companies, taking payments in bitcoins and forwarding the cash equivalent to the vendor involved, which means that his clients are insulated from the cybercurrency's volatility.

Gallippi said many of the businesses are e-commerce websites, but he said an increasing number of traditional retailers were looking to get into the game as well.

"We just had an auto dealership in Kansas City apply," he said.

In March, BitPay said its vendors had done a record \$5.2 million in

bitcoin sales—well ahead of the \$1.2 million's worth of monthly revenue estimated to have coursed through Silk Road last year.

Even artists accept bitcoins. Tehran-based music producer Mohammad Rafigh said the currency had allowed him to sell his albums "all over the world and not only in Iran."

Gallippi said the cybercurrency's ease of access was its biggest selling point.

With Bitcoin, "I can access my money from any computing device at any time and do whatever the heck I want with it," he said. "Once you move your money into the cloud why would you ever go back to putting your money in the bank?"

Many Wall Street veterans are skeptical—and they may feel vindicated after Bitcoin's latest tumble.

"Trading tulips in real time," is how longtime UBS stockbroker Art Cashin described Bitcoin's vertiginous rise, comparing it to the now-unfathomable craze that saw 17th-century Dutch speculators trade spectacular sums of money for a single flower bulb.

"It is rare that we get to see a bubble-like phenomenon trade tick for tick in real time," he said in a note to clients.

One Bitcoin supporter with a unique perspective on the boom might be Mike Caldwell, a 35-year-old software engineer based in suburban Utah. Caldwell is unusual insofar as he mints physical versions of bitcoins at his residence, cranking out thousands of homemade tokens with codes protected by tamper-proof holographic seals—a retro-futuristic kind of prepaid cash.

Caldwell acknowledges that the physical coins were intended as novelty items, minted for the benefit of people "who had a hard time grasping a virtual coin."

But that hasn't held back business. Caldwell said he'd minted between 16,000 and 17,000 coins in the year and a half that he's been in business. Demand is so intense he recently announced he was accepting clients by invitation only.

Some may wonder whether Caldwell's coins will one day be among the few physical reminders of an expensive fad that evaporated into the ether—perhaps the result of a breakdown in its electronic architecture, or maybe after a crackdown by government regulators.

When asked, Caldwell acknowledged that bitcoin might be in for a bumpy ride. But he drew the analogy between the peer-to-peer currency enthusiasts who hope to shake the finance world in the 2010s with the generation of peer-to-peer movie swappers who challenged the entertainment industry's business model in the 2000s.

"Movie pirates always win the long game against Hollywood," he said. "Bitcoin works the same way."

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