

Bitcoin: The Digital Goldrush?

It seems everyone is talking about Bitcoin – this mysterious digital entity that has skyrocketed up in value over 1000% in just a few months!

What is Bitcoin?

Bitcoin is a currency. Traditionally currency is linked to countries – the British Pound, the Canadian Dollar, etc. Each country has its own banks where that currency can be deposited and withdrawn. Bitcoin is not linked to any country or bank, but is equally available to everyone on the planet.

If there are no Bitcoin banks, where is it stored?

Bitcoin may be more accurately described as a digital crypto-currency, meaning that every Bitcoin transaction is stored in a highly secure encrypted repository on the internet called the “block chain”. Every time a Bitcoin purchase is made, or a Bitcoin is bought or sold, a record of this transaction is encrypted and stored on the block chain. The block chain itself is stored and maintained by many hundreds of thousands of computers all around the world running the publicly available Bitcoin block chain software. People running this software are called “Bitcoin Miners”, and receive a small payment (in Bitcoin) as a reward for each transaction they process and enter into the block chain.

How does this Bitcoin block chain keep track of my Bitcoins?

Traditional banks link your bank balance and transaction history to an account number, which is in turn linked to you. In order to withdraw money from a bank account, you must prove to the bank that you are indeed the rightful owner of that bank account. This may involve you typing in a PIN number (something you know), or swiping an eftpos card (something you have). Once you have proved your identity, you are granted access to the bank account.

With Bitcoin, you download and install a Bitcoin wallet app onto your PC or mobile phone. When you set this wallet up, you will be issued with a random set of 12 words which are known only to you. By knowing these 12 words, you prove your identity and gain access to the contents of the Bitcoin wallet.

If you were to then buy some Bitcoin using this wallet, that transaction would be stored on the Bitcoin block chain and the wallet would store a link to that item in the block chain, meaning that you and you alone have ownership and access to that block chain item. You can think of a Bitcoin wallet as a place where you store your keys to get access to your block chain entries.

A word of warning. If you were to lose your phone and have to reinstall your Bitcoin wallet on a new phone and you no longer knew the 12 secret words to your Bitcoin wallet then neither you nor anyone else will ever be able to recover your Bitcoin from the block chain! Those Bitcoin transactions become orphaned and are lost to you forever.

How do I buy Bitcoin?

If you have 100NZD, and wanted USD, you would need to go to a currency exchange, who – for a fee – would exchange your currency at the current exchange rate. Similarly, most Bitcoin wallets have a “buy Bitcoin” link, which will let you buy Bitcoin using your credit card. You need to be very wary indeed about who you hand over your credit card details to, as many stories are emerging of both scam sites

falsely claiming to be “verified, certified Bitcoin exchanges”, as well as legitimate sites charging very high commission rates (10% anyone?) on the purchase (and then again on the sale) of Bitcoin.

Once your purchase has been processed, your Bitcoin balance will be displayed in your wallet.

How much is a Bitcoin worth compared to say USD?

There is a school of thought that says something is worth however much a buyer is willing to pay for it. One person may begrudgingly pay \$100 for a painting, another may pay \$1000 and be delighted with their purchase. In the example of shares, there is a case to be made that the value of a share is a reflection of the underlying value of the company it is linked to. Bitcoin however is not linked to anything physical or real whatsoever! Over the past few months Bitcoin has ceased functioning as a currency and instead been hijacked by frenzied speculation – people buying it in the hope that it will go up in value and they can resell it for a fast buck. It is this speculation that has unhinged the value of Bitcoin from any form of reality and, ironically, rendered it useless as a currency because it is now so unstable.

What does the future hold for Bitcoin?

We pretty much all agree that crypto-currency is a great idea and is the way of the future – but there are a mighty lot of wrinkles to get ironed out before we get there. Some predict Bitcoin will come crashing back down to earth as fast as it shot up, as speculators get the jitters and trigger a panic sell run. Others predict that Bitcoin will die out and be replaced with another crypto-currency (Ethereum? IOTA? Ripple?) which takes into account the lessons learnt and mistakes made with Bitcoin. Who knows? All anyone can say with any certainty is that we are living through the birth of a currency revolution that will fundamentally alter the way we buy and sell.