

INTERNATIONAL JOURNAL OF RESEARCH IN COMPUTER APPLICATION & MANAGEMENT

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BITCOIN: AN OVER VIEW IN INDIAN CONTEXT

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ABSTRACT

This paper deals with the origin and evolution of bit coin as an alternate currency and its acceptance in today's commercial world. The protocol and its growth have been discussed in this paper. India is getting very quickly exposed to this new under experiment currency and shows immense potential in adaption of the currency in times to come. How has the Indian euphoria resulted in opening a new exchange in UAE has also been discussed. The social impact of the new found term BITCOIN is likely to be screen adaptation of a work by Ravi Subramanian. The paper also deals with as to why Would One Want to Use Bitcoins and what are the possible potfalls and disadvantages of Bit-coins

KEYWORDS

Bit coin, digital currency, igot, emoney, legal tender, security breach.

INTRODUCTION

Bitcoin is a form of digital currency, created and held electronically. No one controls it. Bitcoins aren't printed. These are produced by millions of (uncountable) people running computers all around the world, with the help of programmes, that solves mathematical problems. If Dan Brown's theme of Da Vinci Code is to be stretched, bitcoins are first example of a growing category of money known as cryptocurrency.

Bitcoin can be used to buy anything electronically. In that sense, it's like any conventional currency.

Bitcoin's prime characteristic, that distinguishes it from conventional money is that it is decentralized. No institution controls the bitcoin network. This puts some people at ease, because it means that any bank large or small can't control their money.

A software developer called Satoshi Nakamoto initiated bitcoin, which was an electronic payment system based on mathematical proof. The idea was to produce a currency outside the control of any central authority, which was easily transferable electronically- almost instantly, with very low transaction fees.

Bitcoin, which is an electronic currency isn't physically printed in the guarded room of a central bank, nor governed by any rules of the central bank.

Bitcoin is created digitally, by a community of people that anyone can join. Bitcoins are 'mined', using computing power in a distributed network.

The Bitcoin protocol – the rules that make bitcoin work – say that only 21 million bitcoins can ever be created by miners. However, these coins can be divided into smaller parts (the smallest divisible amount is one hundred millionth of a bitcoin and is called a 'Satoshi', after the founder of bitcoin).

Globally, people are using several softwares that follow a mathematical formula to produce bitcoins. The mathematical formula is freely available, so that anyone can check it.

INDIAN CONTEXT

Bitcoin in India is showing plenty of promise at the grassroots level, as demonstrated by 250 undergraduate students who attended a seminar at the HR College of Commerce and Economics in Mumbai last Thursday. Those present already demonstrated a basic knowledge of bitcoin and some of its technical aspects such as block chain transparency and mining, according to Vishal Gupta of the Bitcoin Alliance of India, who headed the presentation.

Cashing on the Indian euphoria over the new currency, Multinational bitcoin exchange igot launched the first bitcoin exchange in the United Arab Emirates (UAE), to capitalize on the unique opportunity posed by the market.

The Australia-based company's founder Rick Day told CoinDesk the new exchange will operate with a Commercial Brokerage License, approved by the local government. It has also secured local banking partners for direct deposits and withdrawals in UAE dirhams. The concentration of high net-worth individuals among its citizens, about 60% of the UAE's workforce consists of expat Indian workers, both professional and manual, who often send their money back home.

In fact, foreign citizens make up a staggering 91% of the UAE's population of 9.2 million, with 1 million Indians representing the country's largest overall group.

Day said that, given that India is currently igot's largest market outside Australia, its presence in the UAE puts the company in a very interesting position.

The exchange is aimed more at consumers than professional traders, with a simple buy-sell interface. However, it recently implemented a feature called 'Future Trade' which functions like limit orders on a more advanced exchange, giving customers the option to set their price and wait for bitcoin's value to rise or fall to that level before executing the trade.

Virtual currency and its evolution is also about to hit the big screen. Viacom last week bought film rights for a thriller novel called God is a Gamer, which is based around the virtual currency and takes the reader through events based on real-life incidents in the Bitcoin world.

The author, Ravi Subramanian is a banker and has already written six books, including *If God was a Banker*, *The Bankster*, *Devil in Pinstripes* and *The Incredible Banker*. Subramanian sees Bitcoin and other crypto currencies as the future of money, though he believes it'll take about 5 years for it to reach the critical mass in India. "I believe Bitcoin is a very convenient way to shop and to transfer money to any account around the world. Governments should work around a framework for the currency instead of putting restrictions on it," said Subramanian.

ANALYSIS AND DISCUSSION

Bitcoin offers users the advantages of lower transaction costs, increased privacy, and long term protection of loss of purchasing power from inflation. However, there are also a number of disadvantages that could hinder wider use. These include sizable volatility of the price of Bitcoins, uncertain security from theft and fraud, and a long term deflationary bias that encourages the hoarding of Bitcoins. Bitcoin also raises a number of legal and regulatory concerns including its potential for facilitating money laundering, its treatment under federal securities law, and its status in the regulation of foreign exchange trading. *Reasons For and Against Wider Use of Bitcoin Why Would One Want to Use Bitcoins?*

Bit coin purportedly offers three potential benefits to users: lower transaction costs, increased privacy, and no erosion of purchasing power due to inflation.

Lower Transaction Costs for Electronic Economic Exchanges because there is no third-party intermediary, Bitcoin transactions are purported to be substantially less expensive for users than those using traditional payments systems such as Paypal and traditional credit cards, which charge merchants significant fees for their role as trusted third party intermediary to validate electronic transactions. In addition, Bitcoin sales are non-reversible, which removes the possibility for misuse of consumer charge-backs, which merchants find costly. Merchants would presumably pass at least some of these savings on to the customer. While there is considerable anecdotal evidence that this is true, there are no comprehensive data on the size of Bitcoin's transaction cost advantage.

Some of the transaction cost advantage could be offset by the slow speed at which Bitcoin transactions currently occur, which, depending on the size of the transaction, can take a minimum of 10 minutes or as long as an hour.

In addition, Bitcoin's advantage in transaction cost could be offset by the substantial volatility of Bitcoin's price. A rising dollar price of Bitcoin is likely to deter potential buyers who would expect to see their purchasing power be greater in the future. A falling Bitcoin price is likely to deter potential sellers who would expect to see their potential sales receipts be greater in the future.

Increased Privacy is an advantage for those who seek a heightened degree of privacy and they may find more comfort using Bitcoins for their (legal) commercial and financial transactions. The risk of identity theft may also be less, and some may find the removal of government from a monetary system attractive.

However, as discussed above, Bitcoin transactions do not have the anonymity afforded by cash transactions, as there is a permanent and complete historical record of Bitcoin amounts and encrypted identities for all transactions on the Bitcoin system that is potentially traceable. No Erosion of Purchasing Power by Inflation Inflation is defined as a broad increase in the prices of goods and services. This is equivalent to saying that there is a fall in the value of the circulating currency. That fall in value means that each unit of the currency is exchangeable for a reduced amount of goods and services. Inflation is commonly thought to be a monetary phenomenon in which the supply of the currency outpaces the demand for the currency causing its unit value (in terms of what it can buy) to fall. Most often governments (or their central bank) regulate the supply of money and credit and most often some degree of mismanagement of this government function is at the root of a persistent high inflation problem. In the case of Bitcoin, however, there is no government or central bank regulating the supply of Bitcoins. The supply of Bitcoins is programmed to grow at a steady rate regulated by the degree of mining activity (a process likely linked to a growing demand for Bitcoin) and then is capped at a fixed amount. Inflation could occur if the demand for Bitcoin decreases relative to the fixed supply. Inflation could also occur if the Bitcoin network develops fractional reserve banking (i.e., banks that hold only a fraction of their deposits in reserve and lend out the rest), which would also be a vehicle that effectively increases the supply of circulating Bitcoins. If these digital banks move to a situation where held reserves stabilize, this source of inflation would diminish.

What Factors Might Deter Widespread Bitcoin Use?

There are a number of factors that could discourage widespread use of Bitcoin. Not Legal Tender The dollar is legal tender and by law can be used to extinguish public or private debts. A creditor is required to accept legal tender for the settlement of a debt. At a minimum, the payment of taxes forces U.S. individuals to hold dollars. Arguably, for many, such a government endorsement is comforting and creates a strong underlying demand for the dollar. By contrast, a currency like Bitcoin that is linked to a complex computer program that many do not understand and that operates without accountability to any controlling entity, could be an unattractive vehicle for holding wealth for many people. Bitcoins Networks Security Is Uncertain While counterfeiting is purportedly not possible, Bitcoin exchanges and wallet services have at times struggled with security. Cash and traditional electronic payment systems also have periodic security problems, but a high incidence of security problems on a system trying to establish itself and gain customer confidence could be more damaging. Some notable examples of security breaches on the Bitcoin network have included the following:

- Hackers mounted a massive series of distributed denial-of-service (DDoS) attacks against the most popular Bitcoin exchange, Mt.Gox, in 2013. Mt. Gox subsequently declared bankruptcy.
- In late August 2012, an operation titled Bitcoin Savings and Trust was shut down by the owner, allegedly leaving around 5.6 million USD in bitcoin-based debts.
- In September 2012, Bitfloor, a Bitcoin exchange, reported being hacked, with 24,000 Bitcoins (roughly equivalent to 250,000 USD) stolen. As a result, Bitfloor temporarily suspended operations.
- On April 3, 2013, Instawallet, a web-based wallet provider, was hacked, resulting in the theft of over 35,000 Bitcoins. With a price of 129.90 USD per Bitcoin at the time, or nearly 4.6 million USD in total, Instawallet suspended operations.
- On August 11 2013, the Bitcoin Foundation announced that a bug in software within the Android operating system had been exploited to steal from users' wallets.
- October 23 and 26, 2013, a Bitcoin bank, operated from Australia but stored on servers in the USA, was hacked, with a loss of 4,100 Bitcoins, or over 1 million AUD.

As of now, Indian laws do not recognise any type of digital or virtual currency. The Foreign Exchange Management Act (Fema) provides an inclusive definition of the term currency and includes all currency notes, money orders, cheques, credit cards and such other similar instruments as may be notified by RBI. It is interesting to note that Fema gives RBI the power to notify "similar instruments" as currency.

In 2000, RBI had notified ATM Cards and debit cards as currency. Therefore, RBI has the power under Fema to also notify Bitcoins as currency if it is able to justify that it is similar to currency notes, credit cards, etc.

RBI, in its press release on December 24, 2013, had warned that the creation, trading or usage of virtual currencies, including Bitcoins, as a medium for payment is not authorised by any central bank or monetary authority. However, it has not banned the use of Bitcoins in India as such. There was also no comment regarding the classification of Bitcoin as a currency in the press release, but former finance minister, P Chidambaram, had given a statement that RBI was examining the issues relating to the usage, holding and trading of virtual currencies, including Bitcoins, under the extant legal and regulatory framework of the country. Different countries have adopted different approaches regarding the classification of Bitcoins as "currency".

In Germany, Bitcoin is not classified as a foreign currency or e-money, but stands as a financial instrument. In the United States, the Internal Revenue Service considers Bitcoin as a form of 'property' rather than a currency for tax purposes.

However, the United States District Court (Eastern District of Texas) has recently ruled that Bitcoin is a currency or form of money. Therefore, it appears that there is confusion regarding the treatment of Bitcoins in other countries as well and perhaps, RBI is waiting for a cue from the international developments.

CONCLUSION

A bona fide currency functions as a medium of exchange, a store of value, and a unit of account, but bitcoin largely fails to satisfy these criteria. Bitcoin has achieved only scant consumer transaction volume, with an average well below one daily transaction for the few merchants who accept it. Its volatility is greatly higher than the volatilities of widely used currencies, imposing large short-term risk upon users. Bitcoin's daily exchange rates exhibit virtually zero correlation with widely used currencies and with gold, making bitcoin useless for risk management and exceedingly difficult for its owners to hedge. Bitcoin prices of consumer goods require many decimal places with leading zeros, which is disconcerting to retail market participants. Bitcoin faces daily hacking and theft risks, lacks access to a banking system with deposit insurance, and it is not used to denominate consumer credit or loan contracts. Bitcoin appears to behave more like a speculative investment than a currency. In the context of India Bitcoin usage will require high regulation as the fear of the actual currency being over taken by the virtual currency will be high.

As regards Indian context, it is viewed that although Bitcoins are accepted by major companies such as Expedia, Dish Network, Overstock, etc. and the India website highkart.com provides the facility to pay with Bitcoins only, it is not a universal medium of exchange. The other major concerns regarding the use of Bitcoins as a currency are the lack of an underlying legal framework, the extreme volatility in its value of a Bitcoin and the fear that it could be used for money-laundering transactions. The lack of a clear underlying legal framework is particularly worrisome.

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