

GOVERNING

THE STATES AND LOCALITIES

Should States Pay Attention to Bitcoin?

As the virtual currency climbs in popularity and value, state regulators would be wise to start figuring out a way to make it safe and user-friendly in their borders, experts say.

By: Liz Farmer - December 5, 2013

As the virtual currency Bitcoin climbs in popularity and in value, state regulators would be wise to start figuring out a way to make the currency safe and user-friendly in their borders, experts said Thursday.

Bitcoins are the world's first decentralized currency, meaning online consumers don't have to rely on a third party like a credit card company or PayPal to process the transaction. Online consumers of course can't use cash to buy something online, but Bitcoins (which are stored in a user's virtual wallet) are essentially the Internet's unregulated version of cash.

The currency is entirely virtual, despite the stock footage of what looks like an arcade coin that commonly runs with news stories on them. Bitcoins are hidden in a complex encrypted computer program and the process by which users find them is called mining. The easiest-to-find Bitcoins (about 12 million so far) have already been mined so it takes great amounts of computing power to find the ones still hiding. There are about 21 million in existence.

Unlike any other currency, Bitcoins are a global one – they don't need any one country to establish legitimacy. Therefore states (and the federal government) ought to be wary of ignoring it. Or even worse, shunning it, said Jim Harper, director of information policy studies, at the Cato Institute.

“If any level of government in the U.S. pushes down too hard on Bitcoin -- especially now while the companies are small -- they will move overseas. And many have,” he said during a panel session at the National Conference of State Legislatures' Fall Forum in Washington D.C. “Many have come into existence overseas in the first place and some U.S. companies have said, ‘We're not going to deal with this we're just going to go somewhere else and do it.’ So it's important to have a light touch no matter what level of government you're talking about.”

Just hours before Harper's comments, China announced it was banning Bitcoin trading by banks (although not banning use among individuals), citing concerns about financial stability. The value of Bitcoin in China took a dive following the announcement as that country has become the biggest market for the currency in recent months.

Although the currency has been around since 2009, November was a big month for Bitcoin. Congress held a hearing on the currency after the FBI shutdown the Silk Road website in October. The website sold drugs and other illegal goods and users paid in Bitcoins, mainly because the transactions are anonymous although the amount exchanged is recorded. The currency, valued at about \$600 USD per

Bitcoin, soared in value following the hearing and is now worth nearly \$1,000 USD. Also in November, the University of Nicosia in Cyprus announced it would begin accepting payment in Bitcoins and the New York State Department of Financial Services announced plans to hold a hearing on whether it should license the currency.

Matthew Lambert, director of legislative policy for the Conference of State Bank Supervisors, told state lawmakers and their staff Thursday that New York's move was "crucial" and one to watch in the coming months. Several states are actively watching Bitcoin's progress, he said, as they try to determine what laws and regulations they have in place might apply to Bitcoin.

Regulating the currency would protect consumers. PayPal, for example, is licensed in all 50 states and if there is an error in a transaction, consumers have recourse. If a Bitcoin user's virtual wallet is robbed or a transaction is hacked (which is not uncommon), the money is forever lost.

The New York hearing would examine a license with consumer protection and anti-money laundering requirements and one that would make the currency less useful in fraud and other criminal activity. At the federal level, the Federal Elections Commission has announced it is taking a look at regulating Bitcoins for purposes of campaign donations.

Still, there are many questions to consider. Wisconsin Deputy Treasurer Scott Feldt noted in a recent opinion statement that it was difficult to predict how Bitcoins would affect the banking industry as banks make substantial revenue from fees, closing costs, and interest. It is not universally accepted and its value is subject to fluctuation and highly volatile, he added.

"Nonetheless, this is a neat concept and undoubtedly something we shall hear more about as the technology evolves," Feldt wrote. "I've been bitten by the Bitcoin concept and will watch to see how 'infectious' it becomes."