

Overview

Since Bitcoin’s creation in 2009, advocates of the digital currency have hailed it as new global currency that could rival the dollar and have argued the Bitcoin network could someday rival traditional payment systems such as Paypal. Regulators, on the other hand, have worried about the anonymity of Bitcoin transactions and its volatility. The Consumer Financial Protection Bureau (CFPB), for example, recently issued a [consumer advisory](#) warning of Bitcoin’s risks. For both regulators and advocates, the question is the same: Can Bitcoin go mainstream?

What is Bitcoin?

Bitcoin is the invention of “Satoshi Nakamoto,” a pseudonymous developer who published a [paper](#) conceptualizing a digital currency untethered to any world government and maintained through an open-source network.

Bitcoins have no intrinsic value in themselves – i.e., they’re not backed by a commodity such as a gold – and are instead what economists call a “[fiduciary currency](#).” In other words, Bitcoins have worth simply because its community of users accepts it as “money” (one reason why its value is volatile).

Users “spend” Bitcoins via the Bitcoin network, which is functionally similar to Visa, MasterCard or PayPal. But unlike these systems, no centralized third-party institution keeps track of and verifies payment transactions. Instead, Bitcoin transactions are recorded in a public “ledger” and verified through a complex, open-source system maintained by its users.

How do you get Bitcoins?

The easy way is to buy them (for dollars or other currencies) at a Bitcoin [exchange](#). The hard way is “[mining](#)” them. Because of the encryption used by the Bitcoin network, verifying transactions requires significant computing power. Users who help verify Bitcoin transactions in the public ledger – called “mining” - are issued newly created Bitcoins as a reward for their efforts.

Under the “Bitcoin protocol,” the number of Bitcoins that can ever exist is capped at 21 million. As of August 2014, slightly more than [13 million](#) Bitcoins were in circulation, and the last Bitcoin is expected to be generated in 2041. After that point, miners will be rewarded with transaction fees for their work in maintaining the Bitcoin network.

Who uses Bitcoin?

According to the Bitcoin Foundation, the value of all Bitcoins in circulation as of August 2013 exceeded [\\$1.3 billion](#). While Bitcoins are far from being universally accepted, a growing number of retailers and [companies](#) are beginning to accept Bitcoin payment, including Overstock.com, Virgin Galactic and automaker Tesla.

Key Facts

- Bitcoin is a global, digital currency that relies on an open-source network to verify payment transactions. It was invented anonymously in 2009.
- As of August 2013, the value of Bitcoins in circulation was roughly \$1.3 billion.
- Mainstream companies accepting Bitcoin now include Virgin Atlantic, Overstock.com and Tesla.
- In January 2013, one Bitcoin was [worth](#) about \$14. By November 2013, the price had spiked to \$979. As of August 1, 2014, one Bitcoin was worth about \$585.
- The number of Bitcoins is capped at 21 million, with about 13 million currently in circulation.

Essential Links

- Congressional Research Service, [Bitcoin: Questions, Answers, and Analysis of Legal Issues \(R43339\)](#)
- Federal Reserve of Chicago, [Bitcoin: A Primer](#)
- Consumer Financial Protection Bureau, [Risks to Consumers Posed by Virtual Currencies](#)
- Government Accountability Office, [Virtual Currencies: Emerging Regulatory, Law Enforcement and Consumer Protection Challenges](#)

What do Bitcoin proponents say are its advantages?

Proponents say Bitcoin transaction fees are lower than for transactions using traditional payment systems, which they argue means a better deal for consumers. Bitcoin experts [Jerry Brito and Andrea Castillo](#), for example, argue that while fees for remitting funds overseas averaged 9 percent through traditional third-party providers in 2013, remittances sent by Bitcoin cost an average of one percent of the remitted amount.

Advocates also say that because Bitcoin is independent of traditional financial institutions, consumers can make payments anywhere in the world at any time. They also argue that Bitcoin could benefit consumers in developing countries without an established banking system.

What are the concerns around Bitcoin?

Unlike credit card transactions, Bitcoin transactions are relatively anonymous, which has led to worries about Bitcoin's use in illegal activities. In 2013, the FBI shut down the online drug market [Silk Road](#), which accepted only Bitcoin.

The Government Accountability Office (GAO) has also expressed [concerns](#) over Bitcoin's use for tax evasion because transactions are difficult to trace.

Bitcoin has also proved volatile so far – experiencing major [fluctuations](#) in price. As an analyst for the Chicago Federal Reserve [observed](#), “Bitcoin is free of the power of the state, but it is also outside the protection of the state.”

What is Bitcoin's future?

To the extent that Bitcoin gains greater mainstream acceptance, it will also attract greater regulatory scrutiny from an alphabet soup of potential regulators.

In addition to the recent advisory from the CFPB, the Financial Crimes Enforcement Network (FinCEN) has issued [guidance](#) on the application of FinCEN regulations to Bitcoin transactions, and in March 2014, the IRS issued [guidance](#) on the tax treatment of Bitcoin holdings.

Bitcoin regulation has also been the subject of hearings by both the [Senate Committee on Homeland Security and Governmental Affairs](#) and by the [Senate Committee on Banking, Housing and Urban Affairs](#).

According to the [Congressional Research Service](#), Bitcoin could also come under the scrutiny of the Federal Reserve (particularly if the Bitcoin “economy” ever grows large enough to have systemic implications) and the Securities and Exchange Commission (which could regulate Bitcoin as an investment, among other things). Bitcoin could also be subject to existing statutes prohibiting counterfeiting and even the Stamp Payments Act of 1862, which essentially prevents competing currencies from being accepted as legal tender in the United States.

Paradoxically, however, the regulation of Bitcoin may actually be the step that Bitcoin needs to gain mainstream legitimacy and recognition.

Other Resources

- U.S. Department of the Treasury, Financial Crimes Enforcement Network, [Guidance on the application of FinCEN regulations to virtual currencies](#)
- U.S. Senate Committee on Homeland Security and Governmental Affairs, Hearing, Nov. 2013, [Beyond Silk Road: Potential Risks, Threats, and Promises of Virtual Currencies](#)
- U.S. Senate Committee on Banking, Housing and Urban Affairs, Hearing, Nov. 2013, [The Present and Future Impact of Virtual Currency](#)
- Satoshi Nakamoto, [Bitcoin: A peer-to-peer electronic cash system](#)
- Jerry Brito and Andrea Castillo, [Bitcoin, a primer for policymakers](#), Mercatus Center, George Mason University
- [Bitcoin Foundation](#)