

# Bitcoin confidence game is a Ponzi scheme for the 21st century

**Summary:** *It's captured the imaginations of enthusiasts all too ready to exchange it for real-world goods, but recent and repeated hacks of Bitcoin's underlying elements suggest the virtual currency is no more real than the Ponzi schemes of yesteryear – and it's only a matter of time until the faithful get burnt.*

By David Braue for Full Duplex | March 11, 2014 -- 05:06 GMT

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Well, colour me surprised. A virtual currency, backed by absolutely nothing except the fierce belief in the integrity of a complex mathematical formula few of its proponents even understand, is proving to be little more trustworthy than the Zimbabwe dollar after hackers tested and defeated controls put in place to manage it fall at the first hurdle.

In developments that should surprise nobody, the disastrous decline of Mt Gox –which has filed for bankruptcy (<http://www.zdnet.com/mt-gox-files-for-bankruptcy-in-u-s-7000027136/>) in the US after being systematically owned and dismembered by hackers – has been followed by hackers' theft of 12.3 percent of the Bitcoin stored at the Poloniex exchange (<http://www.zdnet.com/third-cryptocurrency-exchange-becomes-hacking-victim-loses-bitcoin-7000027052/>).

This is the third Bitcoin exchange to fall already, and the hackers are only just getting started



*Bitcoin might help you get a cheap sandwich, but the owner won't be happy. CC BY-SA 3.0 Targaryen.*

([http://www.cso.com.au/article/539806/withdrawal\\_vulnerabilities\\_enabled\\_bitcoin\\_theft\\_from\\_flexcoin\\_poloniex/](http://www.cso.com.au/article/539806/withdrawal_vulnerabilities_enabled_bitcoin_theft_from_flexcoin_poloniex/)) . As best known methods for compromising Bitcoin are rapidly shared worldwide and new, purportedly-secure currency aggregation points fall like Fort Knox in *Goldfinger*, Bitcoin theft will likely surge – and then die off, as flagging trust and demand drive its value through the floor.

It's not as if the weaknesses in the system haven't been well-known: Bitcoin was similarly shaken three years ago when a hacker snuck into Mt Gox's systems (<http://www.zdnet.com/blog/security/bitcoin-market-flash-crash-and-database-leak-from-mt-gox/8811>) and managed to push the value of a Bitcoin from around \$US13 to just one cent in the blink of an eye.

The repositories curiously entrusted to manage Bitcoin's integrity aren't the only weak point in the system: the virtual currency has given hackers of all stripes something real and tangible on which to focus their efforts.

The rise of Bitcoin-mining malware has not only allowed many of them to use other people's computers to make untold fortunes while they sleep, but shown just how effectively the Bitcoin algorithm – despite assurances to the contrary – is powering an ecosystem that is fundamentally open to malicious manipulation.

Meanwhile, the poor punters are lining up to support Bitcoin because they believe in the importance of virtual currency. It seems like every second day news reports highlight well-meaning cafe owners who proudly display their geek cred – and complete lack of real business acumen – by pointing out that they accept Bitcoin.

Nobody, however, seems to be pointing out that nothing whose worth is so inherently and unpredictably volatile should be used as the basis for real-world buying and selling. At \$13 that cafe owner might be willing to accept one of my bitcoins as payment for my sandwich,

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coffee and Danish – but when the money I paid him is worth \$0.01 a few hours later, he won't be so happy. I suspect his landlord won't be so magnanimous.

Some of the people jumping into Bitcoin at this early date may be hoping to amass a treasure trove of virtual currency on the hopes that increasing future demand will turn them into real-world millionaires overnight. You know, like buying Apple shares (<http://www.zdnet.com/trader-behind-bars-for-30-months-following-apple-stock-conspiracy-7000023419/>) or limited-edition Franklin Mint plates (<http://www.ebay.com/sch/i.html?>

\_trksid=p2050601.m570.l1313.TR2.TRC1.A0.H0.Xfranklin+mint+collector+plates&\_nkw=franklin+mint+collector+plates&\_sacat=0&\_from=R40)  
 . Or, shares in Pets.COM (<http://www.zdnet.com/news/pets-com-bites-last-investor/111777>) .

Sure, everybody likes to make a quick buck. But to pretend that Bitcoin is magically worthy of investment like long-established and carefully-regulated currencies like the British pound or US or Australian dollar, is nothing more than madness. Bitcoin is not a fiat currency and what it resembles, more than currency, is the notorious Ponzi schemes ([http://en.wikipedia.org/wiki/Ponzi\\_scheme](http://en.wikipedia.org/wiki/Ponzi_scheme)) whose value was entirely based on the continuous addition of new investors whose principal funded returns for earlier investors.

Bitcoin will be the same: as level-headed investors realise they are better to put their money in commodities whose value can be compromised in seconds by clever hackers, the currency so enthusiastically embraced by today's punters that there's a cottage industry around Bitcoin ATMs (<http://arstechnica.com/information-technology/2014/03/ars-buys-bitcoins-at-one-of-the-countrys-only-bitcoin-atms/>) will see demand drop so quickly that it will become all but valueless to anybody but the most optimistic speculators.

The governments (and citizens) of Mexico, Zimbabwe and countless other countries have learned firsthand just how problematic this can become, as rapid shifts in demand fuel the deflation of currencies that have left the once-rich penniless and redefined entire countries' economies.

Sure, Bitcoin advocates argue that the underlying algorithm is sound and that the problems are procedural issues related to the individual organisations charged with servicing the market Bitcoin has created. That may be, but Bitcoin needs to exist as part of a real-world ecosystem managed with the same sorts of responsibilities, integrity, governance, and legal repercussions for breaches as are assigned to other currencies.

Many digital-era counterculturalists decry such regulation, arguing that Bitcoin's essential beauty is not only its virtual nature but the fact that it is decentralised, unregulated, and uncontrollable. Yet no viable currency can properly function without layer upon layer of careful control, and it's the height of blind optimism to suggest that Bitcoin will be any different.

Japan's government was set to regulate Bitcoin (<http://www.reuters.com/article/2014/03/04/us-bitcoin-mtgox-nikkei-idUSBREA231Y420140304>) , by some reports, but then decided against it ([http://online.wsj.com/news/article\\_email/SB10001424052702303369904579423730757355014-](http://online.wsj.com/news/article_email/SB10001424052702303369904579423730757355014-)

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IMyQjAxMTA0MDAwNDQyWj) – arguing, in a sparkling case of circuitous logic, that it is not in fact currency and banning banks from selling Bitcoin. This is the same sort of argument by which governments do not regulate vitamins and food supplements with questionable benefits for the simple reason that they are considered to be foods rather than medicines.

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Others might suggest that Bitcoin is building a market that will level off as demand surges, supply levels off, and market mechanisms stabilise. There may be some economic truth in this: the US dollar, for example, is so widely owned and fundamentally important to world commerce that the even the loss of millions in currency would barely register a blip.

But Bitcoin is not the US dollar, nor even the Zimbabwe dollar: it is the Santa Claus of currency, something whose very importance in society relies not on physical evidence but on the power of collective belief. With one core part of the Bitcoin ecosystem falling after another and Mt Gox already responsible for fleecing thousands of outraged customers (<http://www.zdnet.com/mt-gox-launches-call-center-for-frustrated-bitcoin-holders-7000026926/>) out of \$US446 million – enough to make even Ivan Boesky or Michael Milken wince – it seems hard to envision a future for Bitcoin that is much more than a speculator's paradise.

*What do you think? Have you bought into the Bitcoin dream? Is it a pump-and-dump scheme that will fall by the time you've finished reading this article? Or am I just missing something? In which case, feel free to enlighten me – and the others* (<http://www.dailymail.co.uk/news/article-2568258/Wheres-money-Virtual-currency-Bitcoin-turmoil-400million-heist-causes-price-plummet-half-1-200-time-high.html>) *that apparently just don't get it.*

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## About David Braue

Australia's first-world economy relies on first-rate IT and telecommunications innovation. David Braue, an award-winning IT journalist and former Macworld editor, covers its challenges, successes and lessons learned as it uses ICT to assert its leadership in the developing Asia-Pacific region – and strengthen its reputation on the world stage.