EconoMag

The Show that demystifies Economics

Virtual Economies – part 1

Definition©

by Pierre Vercueil

Hi there EnglishWaves listeners, and welcome to another edition of Economag, we'll be having a look at a brand new topic this week: virtual economies. With the growth of the Internet in the past 15 years, the number of virtual economies across the world has steadily increased too. Some of the more well known virtual economies can be found in virtual worlds such as SecondLife (with more than a million active users), or Blizzard Entertainment's wildly popular online roleplaying game, World of Warcraft, which actually boasts more than 12 million players. But what exactly is a virtual economy? How does it work? And what purpose does it serve?

Well, first, it would be a good idea to start with some definitions. In any economy, goods or services are traded or exchanged - but what would a virtual good or product be? Here the word 'virtual' means that the product or service exists only within a virtual world - a computer game would be a good example of a virtual world, where the virtual goods or products connected to the game have value only in that specific virtual world. Since everything is virtual in a virtual economy, a very simple way of thinking about it would be that neither the buyer nor the seller of a product in a virtual world requires anything to be delivered to a physical, real address.

Right, so far, so good! But goods, services or products are traded with currency, or in other words money, so what then is a virtual currency? A virtual currency would be anything that is easily traded in any amount that is convenient for the people carrying out either the buying or the selling. Again, here the word virtual is important, as it means the currency or money is not a physical object like the 5 or 10-euro bank notes we can find in our wallets. For example, in some online computer games, players are awarded virtual currency for advancing to the next level, which they can then use to trade with other players.

If we think about virtual products and virtual currencies, a logical question would be: can virtual currencies buy only virtual products? The answer of course is no. For example, today Bitcoin is a widely used virtual currency for transactions or trading between people in different parts of the world. Released in 2008, Bitcoin was conceived as a system for buyers and sellers to pay each other directly without needing an intermediary - or in other words, a third party such as a bank. Someone selling a real, physical product (let's say for example, a box of apples), can accept payment from the buyer in the virtual currency Bitcoin, and the transaction or trading activity would not go through the banking system.Another way of thinking about this would be comparing it to the way in which one could buy a coffee at

Starbucks by paying the person behind the cash register with a bank note instead of a credit card. With Bitcoin, one is doing the exact same thing but on the internet - or *virtually*!

Bitcoins are earned or created by solving mathematical puzzles, which is more commonly known as ‘mining’. These puzzles are so complex that very powerful computers are needed to solve them. Besides mining, bitcoins are more commonly bought with real-world currencies such as the euro or US dollar, or through exchanging products or services.

Because virtual currencies such as Bitcoin do not go through banks, they allow buyers and sellers to stay anonymous, meaning their identities are not revealed. Now, this however has meant that criminals have been quick to adopt the use of virtual currencies to sell illegal products on ‘black markets’ on the internet. This has also unfortunately meant that many people don’t trust trading conducted in virtual currencies. The online black market ‘Silk Road’ is a powerful example of the way in which virtual currencies can be used to hide illegal activity. Before being shut down by the US government in 2013, the online site allowed people to buy anything from drugs to weapons - all with Bitcoin.