



EconoMag

The Show that demystifies Economics

Virtual Economies – part 4

Black Market©

by Pierre Vercueil

Hi there EnglishWaves listeners, and welcome back to this week's edition of Economag. As you know we're having an in depth look at the virtual world through an economic lens, we defined the virtual economic landscape, and considered what type of products or services are traded in a virtual economy - we also started thinking about virtual currencies. We then moved on to how virtual economies work in online gaming, and how these economies were really some of the first movers in the virtual economic world. We also looked at how real-world currencies move between the real-world economy, and virtual economies, and yesterday further explored the deepening flow of online - or virtual - currencies.

We have covered how virtual economies and currencies can facilitate trade between people, so in other words, they encourage growth. However there is also a darker side to this story. It is evident that virtual currencies currently pose a wide range of money laundering risks. The leading challenge for the virtual currency industry is its anonymous nature, which allows criminals to participate in financial markets and convert, transfer, and withdraw funds without detection. Simply put, virtual currencies like Bitcoin enable people to buy things they should not be buying, and wouldn't be able to buy otherwise, including drugs or counterfeit goods. Lawmakers are certainly aware of this, and have been quick to respond. As far back as 2009, China's Ministry of Commerce announced that under Chinese law, virtual currency could no longer be used to pay for real goods and services.

So if virtual currencies enable people to buy illegal goods because their identities are kept secret, where exactly are they doing the buying? Well, if you're an anonymous seller, looking for an anonymous buyer, it's a good bet that you'd be interested in an anonymous marketplace! That's exactly what has developed on the Internet – online black markets. Silk Road Marketplace was an online black market, best known as a platform for selling illegal drugs. It was part of the so-called Dark Web (the part of the Internet that is not indexed by search engines such as Google or Yahoo), and was operated as a Tor hidden service, such that users were able to browse it anonymously and securely without potential traffic monitoring or regulation. Now for those listeners who might not be aware, Tor is an Internet portal that essentially allows anonymous access to hidden websites.

Silk Road was launched in February 2011, but shut down by the FBI in 2013. Its founder, American Ross Ulbricht was a Master's student in engineering at the time when he launched the site, but it ultimately landed him a sentence of life in prison. Now where does Bitcoin or virtual currencies fit into this? According to an academic study at Carnegie Mellon University in the States, Bitcoin has helped transfer approximately \$1,2 million in sales of illegal

narcotics associated with the Silk Road Marketplace through the use of the virtual currency. When the US government closed Silk Road, the operation involved the government seizure of approximately 26,000 Bitcoins! This shows the exploitation of the virtual currency industry as a breeding ground for laundering money associated with various illegal activities. Criminals engaging in a wide range of illegal activities are attracted to the use of virtual currencies due to the anonymity that they offer. While there are certainly many legitimate businesses and individuals that use online currencies such as Bitcoin, it can also be exploited by terrorists, human traffickers, drug smugglers, illegal weapons dealers, ponzi scheme operators and other types of fraudsters.

Unfortunately, it doesn't end there when considering the risks of the economic virtual world. Virtual economies or currencies also encourage the exploitation of vulnerable people. In 2011, The Guardian, a British newspaper based in London, interviewed a former work camp inmate who claimed that work camp detainees in China were being forced to play online games to accumulate online goods that could be sold for real-world currency. The New York Times also published a story in 2007 about companies in China engaged in "gold farming," paying low wages for long hours spent collecting virtual assets in online games such as World of Warcraft.

Bitcoin has also been connected to stories about privacy breaches and exploitation: a BBC report suggests that malicious programs are now being used to create unwitting networks of computers forced to mine for Bitcoins, so essentially hijack people's computers to force them to run the complicated code aimed at unearthing Bitcoins. So apart from the many exciting aspects of virtual economies, the risks created through incentivising illegal activity is significant too.

That's unfortunately all we have time for today, but join us again when we'll wrap up this theme by looking at the changing regulatory environment surrounding virtual economies, and what the current industry trends suggest about the economic future of the virtual world.