Research report for G20

Regulation of Cryptocurrencies

Arjun Khurana

Deputy President of G20

16th March 2022

Introduction

A cryptocurrency, in simple words, is an encrypted data string that denotes a unit of currency. It is monitored and organised by a peer-to-peer network called a blockchain, which also serves as a secure ledger of transactions (eg. buying, selling and transferring). Unlike physical money, these are not issued by governments or other financial institutions. Cryptocurrency regulation is a controversial topic, and there are various arguments to support each side. Being a highly volatile market, regulation could lead to more stability, which is liked by investors. More regulation would also protect long term investors from potential fraudulent activity within the crypto ecosystem. However, a lot of people oppose new regulation in the crypto market. They say it could hinder innovation and go against the idea of decentralisation around which the entire concept of cryptocurrency is built.

Key terms

- Cryptocurrency - A medium of exchange through a computer network that is not reliant on any central authority, such as a government or bank, to uphold or maintain it.
- Decentralisation - The process by which the activities of an organisation, particularly those regarding planning and decision making, are distributed or delegated away from a central, authoritative location or group.
- Blockchain - A system in which a record of transactions made in bitcoin or another cryptocurrency are maintained across several computers that are linked in a peer-to-peer network.
- Peer-to-peer network - A group of computers, each of which acts as a node for sharing files within the group. Instead of having a central server to act as a shared drive, each computer acts as the server for the files stored upon it.
- Exchange - A cryptocurrency exchange is a digital marketplace where you can buy and sell cryptocurrency.
- Market capitalisation - Cryptocurrency market capitalization refers to the total value of all the coins that have been mined. You can calculate a crypto's market cap by multiplying the current number of coins by the current value of the coins.
- Token - A unit of value on a blockchain that usually has some other value proposition besides just a transfer of value (like a coin).
- Wallet - A place to store your cryptocurrency holdings. Many exchanges offer digital wallets. Wallets may be hot (online, software-based) or cold (offline, usually on a device).
- Regulation - A law, rule, or other order prescribed by authority.
- Volatile - The rate at which the price of a stock increases or decreases over a particular period.
- Bubble - An economic bubble is a situation in which asset prices are much higher than the underlying fundamentals can reasonably justify. Bubbles are sometimes caused by unlikely and overly optimistic projections about the future.

Why has Cryptocurrency grown over the years?

As mentioned above, cryptocurrencies have been built on the idea of decentralisation, so monetary transactions can become more transparent and direct, ensuring confidentiality. In comparison, a person's transaction may be examined by a bank in the cash system. They can be transferred between 2 parties in a simple manner using a P2P network, allowing users to avoid any transaction fees they have to pay when making monetary transactions. Cryptocurrency also facilitates international trade, since there are no interest rates, transaction fees or exchange rates involved. The strong encryption techniques using blockchain also maximise safety and privacy of users' data.

Why should they be regulated?

The price of cryptocurrencies is based purely on demand for them at any given point in time (how much the person is willing to pay for it), making them extremely volatile and unpredictable. Regulating them will make their prices more stable and protect users from making uninformed investments that could cost them a lot of money.

Another reason for regulation could be to prevent a crypto bubble from forming. This is supported by the 2018 cryptocurrency crash, in which most cryptocurrencies were sold off, leading to bitcoin prices falling by 65% from January to February, causing a lot of people to lose considerable amounts of money.

There are also issues regarding cybersecurity. The anonymous and digital nature of transactions make them vulnerable to hackers and cybersecurity breaches. An example of this is the case of 'Coincheck' in 2018, resulting in a loss of $532 million.

What measures have been taken globally to regulate Cryptocurrencies?

Different countries have taken varying measures to regulate the crypto market. For instance, many of them have made them illegal on the basis that they are not considered legitimate and manageable. Examples of these are UAE, Pakistan, Nepal and Morocco. Some countries have allowed citizens to hold cryptocurrency but prohibited using them as a payment tool, making them practically useless. However, most countries accept cryptocurrencies as a legitimate method of payment and suggest measures to regulate them instead.

The EU recognises the potential of cryptocurrency and has established the EUBlockchain observatory and forum, tasked with the following duties:

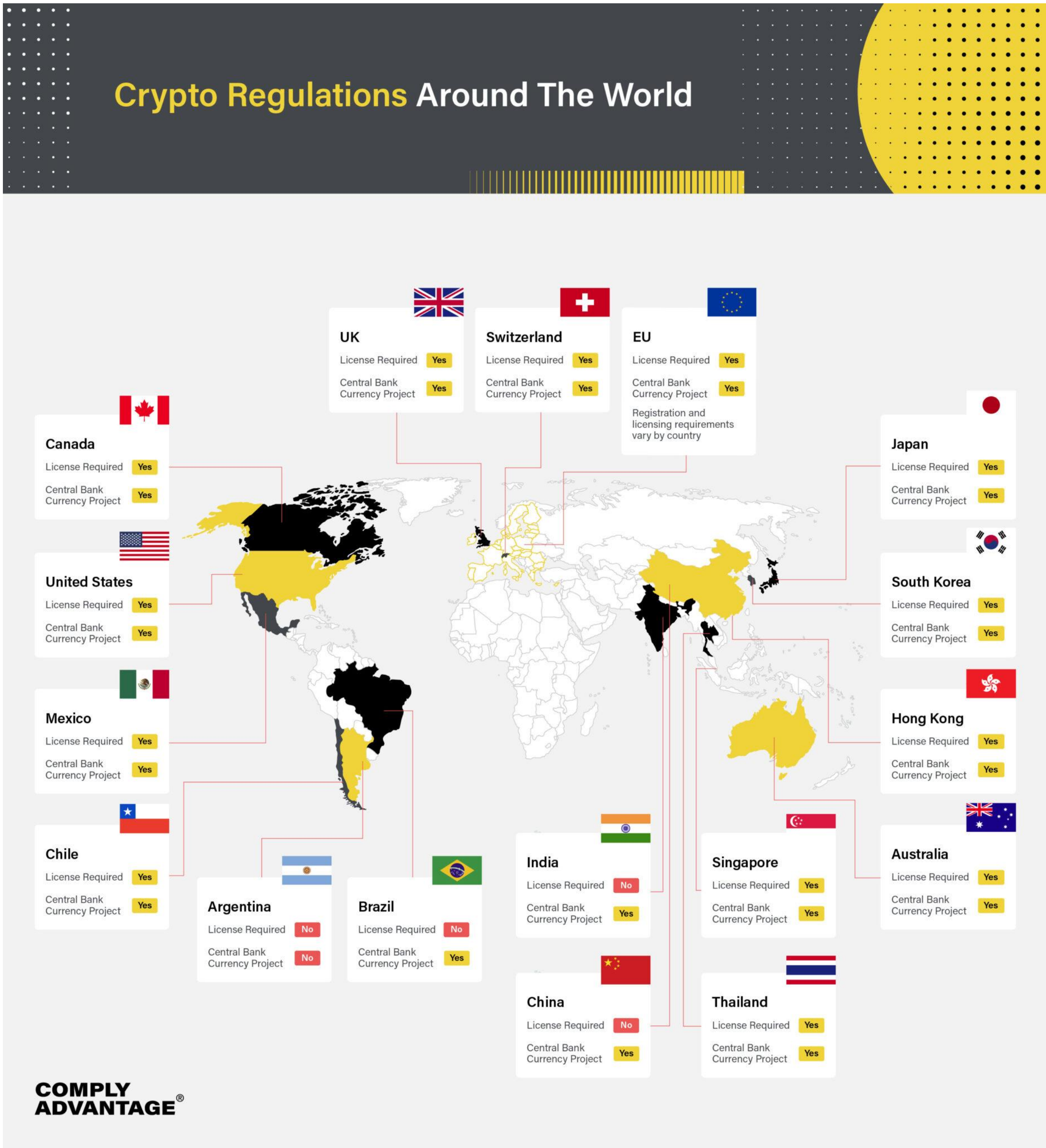
- Monitoring blockchain initiatives in Europe
- Producing a comprehensive source of blockchain
- Creating an attractive and transparent forum for sharing information and opinion
- Making recommendations on the role the EU could play in blockchain

The World Bank has elaborated a series of detailed reports, examining general guidelines for dealing with cryptocurrencies, proposing new ideas for blockchain, such as leveraging it to achieve more sustainable and inclusive supply chains internationally.

The UN gives a lot of importance to this issue as well. They tackle this issue from a multidisciplinary perspective, with ECOSOC dealing with the economic side of cryptocurrency, and the UNODC (United Nations Office on Drugs and Crime) focusing on prevention of money laundering and drug trafficking conjoined with virtual currencies.

Another body focusing on this issue is the FATF (Financial Action Task Force) of the G8. They set the standards for regulation on money laundering and terrorist financing. By proposing the regulation of cryptocurrencies exchanges as “gatekeepers”, the FATF identifies the risk regarding money laundering to be concentrated between virtual currencies and the traditional system. These include currency exchanges as well as the central authority within a traditional system if it performs currency exchange functions.

How Crypto is regulated around the world



Bibliography

- “Cryptocurrency Regulations Around The World”. Complyadvantage, 2022, https://complyadvantage.com/insights/cryptocurrency-regulations-around-world/.
- Gailey, Alex. Time.Com, 2022, https://time.com/nextadvisor/investing/cryptocurrency/why-crypto-regulation-is-good-for-investors/.
- Haar, Ryan. Time.Com, 2022, https://time.com/nextadvisor/investing/cryptocurrency/crypto-terms-you-should-know-before-investing/.
- “Regulating The No Man’S Coin – The Rapid Rise Of Cryptocurrencies Has Regulators Scratching Their Heads | UN DESA | United Nations Department Of Economic And Social Affairs”. Un.Org, 2022, https://www.un.org/development/desa/en/news/policy/cryptocurrencies.html.
- “Seven Reasons Why Cryptocurrency Is So Popular - The World Financial Review”. The World Financial Review, 2022, https://worldfinancialreview.com/seven-reasons-why-cryptocurrency-is-so-popular/
- Smith, Timothy. “Cryptocurrency Regulations Around The World”. Investopedia, 2022, https://www.investopedia.com/cryptocurrency-regulations-around-the-world-5202122.