Suspicions about the Crypto Currencies

What is the issue?

Crypto Currencies run on belief and trust with no regulators and lots of people who tried to floattheir imaginary currencies have failed and it is quite timely for the government and regulators to take a close look.

What are crypto currencies?

- A cryptocurrency (or “crypto”) is a digital currency that can be used to buy goods and services but uses an online ledger with strong cryptography to secure online transactions.
- Cryptocurrencies work using a technology called **blockchain** which is a decentralized technology spread across many computers that manages and records transactions.
- Examples of cryptocurrencies include Litecoin, Ripple, Bitcoin, Ethereum, Dogecoin, Tether, Solana, etc.
- Cryptocurrencies does not come under the Securities Contracts (Regulation) Act, 1956 and hence SEBI is not involved in regulation.
- It does not involve financial institutions and hence RBI is out of the purview.
- It has not been declared illegal by the Courts and hence the government cannot do anything as of now.
- The cryptocurrencies are unique because it is prevalent across the world and more importantly it trades without there being any underlying value.

To know more about the regulation of cryptocurrencies, click here

Which suspicious questions need to be answered by the regulators?

1. Whether crypto is being used as a mode of transaction?
2. How these transactions take place?
3. What about the investment option?
4. What are the implications for the Rupee?
5. How would this threaten the fiscal and monetary policy?

- **Mode of transaction -** Currently there is no information if people are paying in crypto currency.

- We cannot have parallel currencies in the country and allowing crypto as a currency for transactions will undermine the monetary policy affecting the entire system of payments.
- If there is a crash in value, the investors will lose money for which there is no recourse.
- Bitcoin is rendered an inappropriate medium of exchange because the aggregate supply is inelastic and demand shocks result in outsized price volatility.
- To get around this problem, **Stablecoins** have been introduced which provide much greater price stability and hope to serve as viable mediums of exchange.

Stablecoins are the currencies whose value is pegged to a fiat currency by maintaining equivalent reserves.

- **Impact on currencies** - It is unclear whether the transactions are done in rupees and remain in this currency or get converted to dollars.
- If cryptos begin to get mined onshore they will induce capital inflows and will increase capital account volatility which will directly impact the currency market.
- If there are conversions into dollars then there would be Foreign Exchange Management Act (FEMA) rule to deal with.
- The exchanges which promote trading in crypto have to be transparent in terms of doing a KYC because if there is conversion into dollars at any stage it needs to be within the guidelines put by the RBI.
- **Investment option** - It is still not clear if the gains come under short or long term and the IT Department will have to decide on this issue.
- **Gambling issue**s - If one can trade in imaginary currencies it amounts to gambling which is partly permitted in the country.
- If trading in cryptos fall in this category, it can be argued that people should be allowed to gamble on cricket matches too and there should be a level playing field.
- **Threat for central banks -** Some states in the US accept bitcoins for transactions as do some of the Nordic countries.
- Central banks of some countries view that their power over monetary policy are getting denuded.
- **Fiscal policy** - fiscal revenues can be adversely impacted by the increased tax evasion opportunities that crypto-currencies can facilitate.

What approach is the need of the hour?

- There is need for a deep analysis into this entire issue of crypto currency as the level of interest is high and increasing.
- Allowing such investments also risks savings getting diverted for speculative purposes which is not good for an economy that has a big gap in savings and investments.
- IMF points out that if cryptos are only used for niche purposes (narrow cross-country transfers and remittances), which are then quickly converted back into local fiat currencies, the implications for monetary policy can be contained.
- People investing should know what they are up against because when there is a crash there can be an issue.
- The less financially literate need to be educated and maybe a bold print saying ‘trading in crypto can be bad for your financial health’ can be the beginning.

Reference

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