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Cryptocurrency: The Journey and the Future

Since the inception of cryptocurrencies in 2009, the acceptability and use has increased even as such cryptocurrencies evolve. Nowadays, this form of digital money has been started to be accepted by some entities including some nations. However, owing to concerns of certain governments on the deregulated form of cryptocurrencies, certain concerns have been raised. Keeping abreast with the acceptance of cryptocurrencies by various entities, national governments have started to adopt them as legal tender. The recognition of crypto currencies is most pronounced in Japan. Although India has not yet enacted legislation that bans the use of cryptocurrencies, there have been multiple developments in India around cryptocurrencies. With the recent judgment by the Supreme Court of India ('SC') that lifts a ban on the dealing with and provision of services with regard to cryptocurrencies, it is interesting examine how 'online currency' would be regarded in India. This article traces the evolution of cryptocurrencies and endeavours to forecast future trends.

Introduction and Evolution

A cryptocurrency is a digital asset designed to work as a medium of exchange that uses strong cryptography to secure financial transactions, control the creation of additional units and verify the transfer of assets. Cryptocurrencies use decentralised control as opposed to centralised digital currency and central banking systems. In other words, cryptocurrencies are digital currencies in which encryption techniques are used to regulate the generation of currency units and verify the transfer of funds, operating independently of a central bank. The decentralised control of each cryptocurrency works through distributed ledger technology, typically a blockchain, that serves as a public financial transaction database.

In March 2018, the term 'cryptocurrency' was added to the Merriam-Webster Dictionary, which defines it as any form of currency that only exists digitally, that usually has no central issuing or regulating authority but instead uses a decentralised system to record transactions and manage the issuance of new units and that relies on cryptography to prevent counterfeiting and fraudulent transactions.

According to Jan Lansky, a cryptocurrency is a system that meets the following six conditions:

1. The system does not require a central authority; its state is maintained through distributed consensus.

2. The system keeps an overview of cryptocurrency units and their ownership.

3. The system defines whether new cryptocurrency units can be created. If new cryptocurrency units can be created, the system defines the circumstances of their origin and how to determine the ownership of these new units.

4. Ownership of cryptocurrency units can be proved exclusively through cryptography.

5. The system allows transactions to be performed in which ownership of the cryptographic units is changed. A transaction statement can only be issued by an entity proving the current ownership of these units.

6. If two different instructions for changing the ownership of the same cryptographic units are simultaneously entered, the system will perform only one of them.

The first decentralised cryptocurrency is considered to be bitcoin, which was first released as open-source software in 2009. Satoshi Nakamoto, the presumed pseudonymous person (or persons) who created bitcoin, is quoted to have said 'I've been working on a new electronic cash system that's fully peer-to-peer, with no trusted third party.'

The essential keystone leading to cryptocurrency was to create a secure and anonymous medium for transfer of currency from one entity to another and it has since been proclaimed as 'digital gold'. To promote anonymity, blockchain, the digital ledger of bitcoin transactions, was invented.

Blockchain is a continuously growing list that records every cryptocurrency transaction and secures each block using cryptography. Each part of the chain contains a timestamp and transaction data which is approved and stored on a peer-to-peer network. The main security benefits of a blockchain is that once a block has been stored, it cannot be altered, ensuring that any cryptocurrency ledgers can't be tampered with.

Since the introduction of bitcoin, several hundred other cryptocurrencies have entered the market. Initial Coin Offering ('ICO'), a fundraising tool for startups, makes it easier than ever to launch new cryptocurrencies. The first ICO was held in 2013 by Mastercoin. Since then, several cryptocurrencies have begun through this mode. Some of the most popular cryptocurrencies created through this include Ethereum, NEO, Litecoin and Dogecoin. Being alternatives to bitcoin, they are named and commonly known as altcoins (alternative variants of bitcoin or other cryptocurrencies). Altcoins are a more accessible alternative to bitcoin as they are sold at cheaper rates.

Cryptocurrencies have still not entered into day-to-day use despite the massive hikes in their price. Most of those who own substantial amounts of bitcoin are doing so as an investment, rather than looking to utilise cryptocurrency as a new way to buy things. This does not mean that one cannot buy things with cryptocurrency; in December 2013 a Tesla Model S was bought for 91.4 bitcoins and Starbucks, in some nations, is currently letting customers use cryptocurrency to purchase food and drink from their stores.

Blockchain is a continuously growing list that records every cryptocurrency transaction and secures each block using cryptography.

Jamie Dimon, CEO of JP Morgan has claimed that the original cryptocurrency is a fraud. In his words, 'The currency isn't going to work. You can't have a business where people can invent a currency out of thin air and think that people who are buying it are really smart.'

Despite a few outlets allowing the use of cryptocurrency to purchase goods, they have still not made their way into the banking sector. A surge in popularity is leading more and more people to invest in bitcoin and altcoins, but with a new currency on the rise, banks are starting to realise they need to adapt.

Impact of Cryptocurrency

Crypto Impact on the US Dollar

The US dollar is the global economy's reserve currency. As a result, any turmoil or fluctuation in the US dollar raises concern in all parts of the world. The reason the United States continues to maintain dominance is the status of the dollar. The Treasury of the United States houses the assets of other central banks and is therefore considered a global central bank. This is an excellent example of a centralised system which has been drastically disrupted by cryptocurrencies.

Neither bitcoin nor any other cryptocurrency has recourse to or dependence on any other currency. This changes everything: international trade, diplomacy, international relations, etc. The appearance of a decentralised currency seems the perfect way to de-dollarise the world's economy.

Coexistence of Two Currencies

According to Gresham's law, 'bad money drives out good'. Applying this principle, money with minimal real value (like paper for cash), competes with high-cost material money (such as gold coins or cryptocurrencies with expensive IT infrastructure behind them). The dominance of fiat currency is obvious and it is not going to vanish with the appearance of cryptocurrencies. Coexistence of two currencies will cause constant price-ratio fluctuation and competition until one supplants the other.

Price Inflation

If a country accepts cryptocurrency as legal tender, it must be a digital currency characterised by unlimited maximal supply and an unfixed coin emission rate correlated with real sector economic growth. Otherwise, the economy is left to wait for real price inflation or deflation, which represents a huge step backward. In fact, implementing any new technology can be fraught with the problems with inflation or deflation.

High Transaction Costs

Comparing the transaction costs of cash and cryptocurrency, fiat currency wins by a significant measure. The lower transaction costs are, the more actively the economy develops, which itself leads to higher profits and benefits. Until the blockchain is fully implemented, cryptocurrency transaction costs (the financial and time-related costs of using crypto instead of fiat, such as device usage, internet, and time for verification of transactions) will interfere with the development of cryptocurrency as a match for fiat.

No Need for the Middleman

The international money transfer system requires third parties, such as banks or SWIFT (Society for Worldwide Interbank Financial Telecommunication). Money transfer in the context of international business consumes time and fees. Some transactions with SWIFT take several days to be processed. Working on the blockchain platform, the transaction will be fast, secure and, if necessary, encrypted, to protect the confidentiality of the transaction. This is how it works in theory but taking into account the lack of technical expertise of the community, the process in practice is more chaotic and complicated. In fact, full blockchain-based payment system implementation requires much more than what an ordinary citizen can achieve.

Unemployment

In the beginning, financial and other service industries will experience huge job loss arising from the dependency on technology and less manpower to run the same. Since there will be no need for bank services, suppliers, etc., people will most likely lose their jobs. However, this will be temporary. Blockchain will provide new opportunities for employment and people will be able to retrain and become a part of our future, but it needs to be borne in mind that the newer jobs would be technology-oriented.

De-monopolisation

Increase in transaction costs will cause de-monopolisation, which will have a beneficial impact on the welfare and efficiency of the economy. The growth of transaction costs leads to an increase in enterprise growth costs versus the price for involvement of third parties from the market. This will be a chance for small and medium businesses to enhance their enterprises, while large ones will concentrate on capital-intensive production, where blockchain has no real tools for improvement.

Financial Fraud Elimination

Owing to the fact that all transactions are open and wallets are trackable, trade of illegal goods has seemingly fewer options for actualisation. On the public blockchain, any transaction to a wallet which is illicit will immediately be flagged and be considered money laundering. This can be caused by the human error as well as by fraudulent intention or action. However, it has more advantages than disadvantages; any fraudulent activity is rigorously tracked and eradicated.

International Approach

Background

In 2016, cryptocurrencies were on the minds of almost everyone in the world. There was almost no financial institution, government, or banking firm that wasn't researching the crypto market with a view of understanding its impact and consequence of cryptocurrencies for their fields. Some thought of investing in it, while a few started blockchain projects and others awaited to receive further information to then form an opinion. However, as it is still a young technology, only a few entities and individuals fully understand the principle of cryptocurrency and blockchain work.

A majority of the nations have not stated anything with respect to their stand on digital money, unlike some others, which have accepted it as a payment tool. The approach by various countries is discussed below.

Japan

Japan is the only country that has accepted bitcoin as legal tender, living up to its image of being one of the most innovative countries. There already are several bitcoin ATMs around Japan, but that's not even the best news. GMO Internet, a Japanese company, will provide the opportunity to receive salaries in bitcoin, if employees so wish.

Yoshitaka Kitao, CEO of SBI Holdings, has claimed that blockchain technology and bitcoin as legal tender will fuel a skyrocketing economy. He said that there is huge speculative demand for any cryptocurrency, especially bitcoin. This eventually increases its price. Fortunately for Japan, he expects a technological boom to happen in the coming years.

The United States

The issue about bitcoin legitimacy in the US hinges on the question: should it be regulated on the national level or separately by individual states? For now, some states are more progressive in their relations with cryptocurrencies than others. For example, New York gave an official 'yes' to businesses built on the blockchain by issuing BitLicense in 2015. The State of Washington, for instance, started supporting money transfers in bitcoin in 2017. New Hampshire is making its first steps toward accepting bitcoin transfers. In Texas, the situation becomes somewhat more intense, where unlike New York accepting bitcoin as legal tender, Texas has banned it. California is somewhere in the middle. The State has been freezing the process over time.

Bitcoin legitimacy in the US is just a question of time. A good reason for this is that the Wall Street titan and securities and investment firm Goldman Sachs is moving towards allowing clients to sell bitcoin via one of their New York desks. This was foreshadowed by the fact that several hedge funds received donations from bitcoin millionaires. Therefore, by implementing acceptance, they are envisaging a future bitcoin price increase.

Germany

Germany is considered one of the most forward-thinking countries. In August 2013, the German Government announced that cryptocurrencies could be used for tax payment and trade. However, purchases paid in bitcoin must include a value added tax ('VAT'). Also, Bundesbank is offering the use of the term 'crypto token' instead of 'cryptocurrency' or 'digital money'. Crypto tokens don't have a status of foreign currency, but personal money.

The United Kingdom

With regard to bitcoin use, the UK is following a path similar to the German treatment of cryptocurrency. If you want to exchange bitcoin for fiat currency (pounds sterling, euro, dollar, etc.), there is no VAT included, unlike when a purchase is made with bitcoin payment. The same is true for receiving services.

The UK government has established a department called 'CryptoUK', which works to address issues regarding the crypto market. This body ensures security measures and is building an anti-money-laundering approach.

Singapore

The Monetary Authority is willing to protect the rights of cryptocurrency investors. They are referring to a set of rules that would be required in order to provide a legitimate bitcoin investment process. Additionally, the authorities are willing to adopt laws that will play against money laundering and financial terrorism.

Additionally, the Singapore Monetary Fund and Singapore Exchange have established a partnership in order to allow financial institutions and corporate investors to establish a cryptocurrency exchange. This partnership will allow institutions using DvP (Delivery versus Payment) the opportunity to issue their token on different blockchain platforms legally. This move would include rights protection.

India

To date, there is no law that forbids or allows mining, investing or paying with bitcoin in India, but the Reserve Bank of India has warned citizens and judicial parties about bitcoin. This is not to say that bitcoin is illegal in India, as this is difficult to claim due to the absence of relevant laws. However, banks are not able to provide the exchange service.

In a recent judgment by the Supreme Court of India in a case between Internet and Mobile Association of India and the Reserve Bank of India, the apex court has allowed banks to handle cryptocurrency transactions from exchanges and traders.

Russia

In January 2018, the Russian Finance Ministry drafted a bill that would legalise 'digital financial assets' stored on blockchain networks as electronic securities. The bill would define the scope of regulations on cryptocurrency and would not prohibit trading. The bill would further define bitcoin mining as an entrepreneurial activity, which could require Russian bitcoin miners to register with the government. It may also create a ruble ICO investment limit for residents who are not registered as qualified investors.

France

Bruno Le Maire, the French Minister of the Economy, in January 2018 announced the creation of a group to develop cryptocurrency regulations. The group will be responsible for proposing guidelines and drafting regulations to prevent tax evasion, money laundering, financial crimes and terrorist activities. Le Maire said, 'We want a stable economy. We reject the risks of speculation and the possible financial diversions linked to bitcoin'.

Recent Trends in India

RBI Circular of 6 April 2018 Banning Cryptocurrency

The Reserve Bank of India ("RBI') issued a circular entitled 'Prohibition on Dealing in Virtual Currencies (VCs)' bearing no. RBI/2017-18/154 dated 6 April 2018 ('the Circular') whereby it decided that entities being regulated by it shall not deal in or provide services with respect to virtual currencies. The Circular states that entities regulated by the RBI are prohibited from 'providing any service in relation to virtual currencies including those of transfer or receipt of money in accounts relating to the purchase or sale of virtual currencies'.

In the Circular, RBI had said that in view of risks associated with virtual currencies, as highlighted by it in the previous public notices issued by it, entities regulated by the Reserve Bank:

> … shall not deal in VCs or provide services for facilitating any person or entity in dealing with or settling VCs. Such services include maintaining accounts, registering, trading, settling, clearing, giving loans against virtual tokens, accepting them as collateral, opening accounts of exchanges dealing with them and transfer/receipt of money in accounts relating to purchase/sale of VCs.

The RBI also added that if entities it regulated were providing such services, they would have to terminate and exit from such relationships within three months from the date of the Circular.

A Bill Moved in the Parliament of India for the Banning of Cryptocurrencies

A bill entitled 'Banning of Cryptocurrency and Regulation of Official Digital Currency Bill 2019' ('Bill') has been drafted, however has not been presented for a vote before the Parliament of India, which aims to prohibit cryptocurrency and regulate the official digital currencies. As per the Bill, the object is that it is 'An Act to prohibit the use of Cryptocurrency, regulate the Official Digital Currencies and for matters connected therewith or incidental thereto', which shall extend to the whole of India.

The Bill prohibits dealing in cryptocurrency in any form. However, it provides that the Central Government in consultation with the RBI may approve Digital Rupee to be a legal tender, which would be governed by the regulations notified by the RBI. It further empowers the RBI to declare any official foreign digital currency as foreign currency in India.

The Bill further provides for penalties for offences and breach of the provisions which may go as high as 10 years imprisonment and/or a fine of Rs. 50,00,00,000 (Rupees Fifty Crores only).

The Bill also provides for consequential amendments to the Prevention of Money Laundering Act 2002.

As mentioned, the Bill has not been presented before Parliament. Only once it has been passed by Parliament and notified in the Official Gazette would the final position of the Government be clearly manifested.

Judgment by the Supreme Court of India Allowing Cryptocurrency in the Case of Internet and Mobile Association of India v Reserve Bank of India

Among the parties that challenged the Circular was the Internet and Mobile Association of India ('IAMAI'), whose members include cryptocurrency exchanges. A three-judge bench of the Supreme Court of India comprising Justices Rohinton Fali Nariman, S Ravindra Bhat and V Ramasubramanian pronounced the verdict dated 4 March 2020.

The IAMAI, argued that the RBI did not have the jurisdiction to ban dealings in VCs. It was further argued that trading in VCs was legal. The chief arguments raised by the petitioner, IAMAI, were as follows:

- The RBI has no jurisdiction to act in the manner as it had in light of the Circular, as cryptocurrencies are neither 'currency' nor a 'payment system' regulated by the RBI. Simply because cryptocurrencies can be used in a manner akin to money, it does not change the basic legal characteristic of cryptocurrencies, which resemble tradable digital goods or commodities more than they resemble a form of currency and are, thus, outside the purview of RBI's usual scope of regulation.

- The Circular amounted to an arbitrary, unfair and unconstitutional restriction on a legitimate business activity. In the absence of a 'legislative' ban on cryptocurrencies that declares them res extra commercium, the use of and trade in cryptocurrencies ought to be a legitimate business activity.

- The Circular effectively placed a complete ban on the use of cryptocurrencies and such a ban was unreasonable and disproportionate and based on an erroneous and flawed understanding that it was impossible to regulate cryptocurrencies.

The RBI maintained that actual cryptocurrency had not been banned but dealing in virtual currency and providing related services has been banned. The arguments advanced by the RBI were primarily:

- Widespread use of cryptocurrencies would fundamentally undermine India's credit system and monetary stability.
- The RBI had the right to regulate banking activity (which is what the Circular pertained to) as it saw fit.
- It was suspected that cryptocurrencies were capable of being used for illegal purposes.
- In any case, the RBI has the authority to make broad-based decisions on the economic policy of the country and the SC has traditionally shown deference to RBI's authority.

The RBI maintained that actual cryptocurrency had not been banned but dealing in virtual currency and providing related services has been banned.

The SC held that while cryptocurrencies do not constitute legal tender (either in India or in several other jurisdiction that the SC analysed), they can act either as a medium of exchange, a unit of account or a store of value (or some combination thereof). The RBI has the statutory authority to notify certain instruments as currencies. The SC observed that the RBI has not chosen to exercise this power with respect to cryptocurrencies. As a matter of fact, the RBI has specifically argued in the past that cryptocurrencies do not fall under the statutory definition of 'currency'. Nevertheless, the SC concluded that the manner in which cryptocurrencies are often used in India—as consideration for goods or services provided or as a facilitator of payment between parties—constitutes an activity that falls within the RBI's regulatory purview.

After concluding that the RBI did indeed have the power to regulate cryptocurrencies in India, the SC went on to evaluate the Circular on its merits. While the SC rejected the argument that there had been no application of mind in the RBI's directives and that it did not find the Circular to be a colourable exercise of power, the SC ultimately concluded that the Circular was a disproportionate regulatory measure. The SC noted that the RBI is primarily responsible for the financial institutions it is mandated to regulate and that it had argued about the potential harms that cryptocurrencies could cause to these institutions. However, the SC held that the RBI had failed to actually demonstrate the damage that the use of cryptocurrencies had caused to such regulated entities, in light of the fact that cryptocurrencies were not actually banned under Indian law.

As a result, in prohibiting regulated entities from dealing with a sector that was not subject to a statutory ban and which had not demonstrably harmed such regulated entities, the RBI was held to have acted disproportionately and the Circular was set aside.

While the judgment does not itself hold that cryptocurrencies cannot be banned altogether, its analysis of cryptocurrency legislation in other jurisdictions suggests that an Indian regulatory framework for cryptocurrencies is worthwhile and that an outright ban may be uncalled for. News reports indicate that the RBI is also likely to seek a review of the SC's decision in this case, and that being the case, the matter is far from resolved.

Way Forward

Cryptocurrency represents the beginning of a new phase of technology driven markets that have the potential to disrupt conventional market strategies, longstanding business practices and established regulatory perspectives, to the benefit of consumers and broader macroeconomic efficiency. Cryptocurrencies carry ground-breaking potential to allow consumers access to a global payment system, anywhere any time, in which participation is restricted only by access to technology, rather than by factors such as having a credit history or a bank account.

The decision of the Supreme Court of India is an important development for the cryptocurrency sector in India. It removes regulatory restrictions on banks from providing services to participants in the sector and makes cryptocurrency activities viable in India. It is anticipated that several operators of prominent cryptocurrency exchanges, many of whom had ceased Indian operations or moved to other jurisdictions such as Singapore, will contemplate a move back to India pursuant to the judgment. While it remains to be seen whether they do indeed return to Indian shores, considering that the RBI and the Indian Government remain sceptical of cryptocurrencies, this is still a highly encouraging development for activity in this sector and even generally.

For now, there remains some uncertainty about the future of the cryptocurrency industry in India, also in the context of the Banning of Cryptocurrency and Regulating of Official Digital Currency Bill 2019 which, as discussed above, proposes a ban on private cryptocurrencies and the criminalisation of their use. The Bill has not yet been brought to the Indian Parliament for a vote and is thus subject to revision. Further, the Bill proposes the creation of a 'digital Rupee' that the Central Government and the RBI would have a monopoly over, so the Government's general position on cryptocurrencies is clearly not as unfavourable as one would expect it to be. The consequent questions that arise are: whether this will extend to an acceptance of decentralised, non-Government cryptocurrencies and whether private players will be permitted to participate in an Indian cryptocurrency market that has significant scope for growth? Another interesting question that arises is in regard to the treatment of cryptocurrencies: whether the remittances in cryptocurrency would be considered as foreign currency receipts. Though there is a long way to go in this sphere, if any such payment mechanism is to be introduced, it would need legislative backing to be treated as an official tender.

The SC judgment sends a clear message to the regulators—banning technology is not the solution as bans seldom work; embracing and regulating it is the only way. Framing and implementing comprehensive and effective regulations on cryptocurrencies are one of the most challenging regulatory problems of recent times (with regulators across the world struggling with it).

In the end, it can only be said that the courts have kept pace with changing realities and consequently an Indian citizen can now park funds in a non-sovereign electronic currency. They can gift, will and even make payments for international trade and commerce using the same. The need of the hour is for the Government to draw up efficient and elaborate rules for same. The discussion is no longer one of whether cryptocurrency will survive, but rather how it will evolve and when it will reach maturity.

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