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## Money & Banking

# What's next in the world of cryptos and blockchain?

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Jaideep Reddy | Vaibhav Parikh | Updated on April 20, 2021



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The past year has seen an immeasurable surge in interest, particularly institutional interest, in cryptocurrency (also known as crypto-assets, digital assets, or virtual currency) and blockchain. Major developments

include Visa announcing settlements using cryptocurrency, PayPal allowing its users to buy, sell and hold cryptocurrency, Tesla announcing a \$1.5-billion investment in Bitcoin as well as willingness to accept Bitcoin as payment for its cars, and Morgan Stanley adding Bitcoin exposure to 12 of its mutual funds' investment strategies.

## **What is it?**

Bitcoin, conceived in 2008, was the first cryptocurrency, and the first instance of blockchain technology. Cutting the clutter, what it enabled was the transfer of value across the Internet without requiring an intermediary. Traditionally, trusted intermediaries such as banks or stock exchanges have always had to intermediate such transactions, which is perceived to drive up costs and result in a single point of failure. Bitcoin aimed to reduce these costs and decentralise the risk of any potential failure. It also allowed transactions to be cryptographically verifiable by anyone, as transactions are recorded on a public ledger.

While Bitcoin was simply focussed on value transfer, new blockchains such as Ethereum extended the same concept to all manner of computer applications –file storage, voting, and decentralised exchanges. For instance, while most of us use file storage services run by popular tech companies, a blockchain-based system would not be dependent on any single entity. It is another matter that intermediaries are still important in the cryptocurrency and blockchain ecosystem, as they help make the technology easy to use. To make an analogy, while one can theoretically set up their own e-mail server, most of us choose popular e-mail service providers.

## **Pros and cons**

Cryptocurrencies and blockchains bring many advantages, including cost-savings, decentralisation and transparency. Various government agencies have recognised this. But blockchains are not a magic bullet, and like any technology, come with trade-offs. Government concerns include volatility, money-laundering, risks to the monetary system, foreign exchange control, tax evasion and cybersecurity.

But cryptocurrencies and blockchains are platform technologies like the Internet. Where the Internet enabled the transfer of information nearly instantly across borders, cryptocurrencies enable the transfer of value in a similar way, leading to the moniker, the 'Internet of Value'. Like information, value transfer can be positive or negative. While the Internet enables family and friends to bond across borders like never before, it also enables child pornography and other criminal activities at scale. Similarly, cryptocurrency is being used by legitimate commercial and non-profit enterprises, including UNICEF, which launched a 'CryptoFund' allowing it to receive and disburse cryptocurrencies to fund projects in emerging markets, and the World Food Programme, which is using cryptocurrency networks to expand refugees' choices in how they access and spend their cash assistance. With new use-cases like Non-Fungible Tokens (NFTs) and smart contracts, software developers and creative professionals across the world, including India, are finding new opportunities for growth and expression. Doubtless, cryptocurrencies are also being used by bad actors for purposes like extracting ransom remotely or trading in illegal goods. As discussed below, the answer to this has to be regulation and not prohibition.

## **Regulation and prohibition**

When a 2019 Inter-Ministerial Committee (IMC) report proposed an outright ban on cryptocurrencies in India, along with a 10-year jail term even for holding cryptocurrency, participants in this nascent but fast-growing ecosystem in India were shocked and disappointed.

The proposal of the IMC has so far not been acted on, and since then, public statements by government stakeholders have been more measured, with the Finance Minister stating that the government will take a calibrated approach towards cryptocurrency and that a proposal would shortly be presented to the Cabinet. Potentially encouraging signs in this regard are the Ministry of Corporate Affairs recently requiring companies to disclose cryptocurrency holdings on their balance sheets, and statements in Parliament regarding how cryptocurrencies are taxed under income tax and GST laws. At a policy level, regulating cryptocurrencies has the advantage of maintaining oversight of the system (through exchanges, for instance). It avoids the risk of bad actors merely moving underground while good actors are deprived of access to a legitimate technology and asset, forcing them to move overseas.

Further, banning cryptocurrency would sever much more than investment and trading – it would cut off many kinds of blockchain applications that use tokens, some of which are used by major Indian and international enterprises. It would also eliminate a burgeoning ecosystem of thousands of blockchain software developers, who need to use tokens to pay the blockchain network to run their applications. Regulators should look at a broader perspective and, besides regulating trading, consider enabling regulations for securities tokens and Initial Coin Offerings, utility tokens, NFTs, etc., all of which will spur innovation in their respective sectors.

From a Constitutional perspective, legitimate trade can only be restricted by reasonable measures. Outright bans have been disfavoured by the Supreme Court unless there is no less invasive measure available. Besides

the fundamental right to trade, other rights at stake are the rights to property and privacy, and the right against arbitrary or discriminatory State action.

The Supreme Court, in March 2020, found that the Reserve Bank of India circular prohibiting virtual currency transactions through regulated banking channels was disproportionate and violated the fundamental rights of cryptocurrency exchanges. Any outright ban on cryptocurrency is a far more extreme step – confiscating an estimated Rs. 7,000 crore worth of legitimate assets from 70 lakh Indians – and is likely to face an uphill battle to pass muster.

### **Alternatives to a ban**

On the other hand, several alternatives to a ban are available.

Cryptocurrency intermediaries (exchanges and wallet providers) should be licensed like financial sector intermediaries and subject to various checks and balances including KYC norms (currently being followed by self-regulation). Leading jurisdictions, including the US, UK, EU, Canada, Australia, Japan, Singapore, and even countries with exchange controls like South Korea, have found ways to successfully regulate cryptocurrency without resorting to a ban, despite having the same regulatory concerns as India.

Along with their benefits, powerful economic phenomena have historically presented concerns, and we are still grappling with the role of cash in money-laundering and with ensuring investor protection in the stock market.

Interestingly, a 1948 Government of India report observed that “[n]ot only the organisation of the stock market was found defective, its functioning has also often been detrimental to the interests of investors and of the national economy as a whole. Safety for dealings is largely non-existent... Perhaps the most objectionable feature is the violently fluctuating character of prices in the stock market.”

Needless to say, the stock market was never banned in India.



(The writers are Leaders, Technology Law, Nishith Desai Associates)

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