Cryptocurrency (lack of) Regulations:

OVERVIEW, RISKS, AND OPPORTUNITIES

By: Dr. Mohamad Hussein Mansour,
Consultant at the World Bank Group, Lecturer at AUB and LAU

In early 2017, cryptocurrency became a global ubiquitous topic when Bitcoin value to US dollar increased in over 200 percent from 2014, and by around 4,000 percent by late 2017. This rapid increase is reflected in the nominal value of Bitcoins from less than $0.01 in May 2010 to more than $19,700 on December 17, 2017. Since then, cryptocurrency has been viewed by many as an easy way of making profit, and despite being decentralized and unlinked to any central authority, cryptocurrencies gained trust among individual investors and firms. Recently, as Elon Musk announced his interest in purchasing Bitcoins, and Tesla announced the purchase of $1.5 billion Bitcoins, the cryptocurrency's value surged with around $12,000 increase to reach $44,000 in February 2021.

With all the hype and positive news on cryptocurrency and the consequent opportunities to make profits, certain questions on the accompanying risks arise. The first natural risk is the possible devaluation of the cryptocurrency like any other currency or commodity due to lower demand or increased supply. In this regard, while Bitcoin is not the only cryptocurrency, but despite its success it still had periods in which its value dropped hundreds and even thousands of US dollars in a short period of time.

In addition to the volatility risk of cryptocurrencies, the risk of technical glitches and hacking remain where the world had witnessed numerous scams and hacking incidents costing firms and individuals hundreds of millions of dollars worldwide. This type of risk also includes the risks of human errors that might lead to sudden loss of huge amounts of money.

However, natural devaluation technical glitches, despite their enormity, are not the only risks nor the main ones. In fact, the greatest risk with cryptocurrency is in the nature of the currency as a decentralized currency with no central authority like central banks or governments' interference to control or even regulate its use. To this, more than 130 countries as well as international organizations have recently issued laws and policies to regulate cryptocurrencies. These country regulations can be categorized into different groups based on the governments' approach. Not only did the regulations differ, but also the definition of cryptocurrencies themselves, which includes digital currency (Argentina, Thailand, and Australia), virtual commodity (Canada, China, Taiwan), crypto-token (Germany), payment token (Switzerland), cyber currency (Italy and Lebanon), electronic currency (Colombia and Lebanon), and virtual asset (Honduras and Mexico). Moreover, while governments have issued certain regulations, they still warn their citizens that using these currencies are done at the citizens' own responsibility, which indirectly raises awareness on the potential risks associated with such business.

The first category of countries is one that goes beyond raising awareness on the risks of cryptocurrencies, but also warns against the use of such currencies for money laundering and financing terrorism. These countries include Australia, Canada and the Isle of Man, which recently enacted laws to bring cryptocurrency transactions and institutions that facilitate them under the ambit of money laundering and counter-terrorist financing laws.

The second category of countries went further in limiting the use of cryptocurrencies by restricting investments. Several subcategories can be found within this category: i) countries banning any and all activities involving cryptocurrencies, like Algeria, Bolivia, Morocco, Nepal, Pakistan, and Vietnam; ii) countries that ban their citizens to invest in cryptocurrencies domestically, but allow them to do so abroad, like Qatar and Bahrain; and iii) countries with less strict measures on citizens, but with restrictions on domestic financial institutions to facilitate the transactions in cryptocurrencies. These countries include Bangladesh, Iran, Thailand, Lithuania, Lesotho, China, and Colombia.

The third category of countries regulate initial coin offerings (ICOs), which use cryptocurrencies as a mechanism to raise funds. While some are less strict in their ICO regulations, others like China, Macau, and Pakistan ban them completely. On the other hand, New Zealand and the Netherlands are more flexible and depend on whether the currency is debt security, equity security, derivative, or if it is a collective investment.

While the above categories have "hostile" measures towards cryptocurrencies, the fourth category views cryptocurrencies as opportunities if approached with "friendly" regulations. The purpose of such policies are to attract investment in technology. Countries in this group include Spain, Belarus, the Cayman Islands, and Luxemburg.

The fifth category includes countries that have went further developed their own system of cryptocurrencies. This list includes Marshall Islands, Venezuela, the Eastern Caribbean Central Bank (ECCB) member states, and Lithuania. This category also includes countries that had previously banned or restricted use of cryptocurrencies, like Belgium, South Africa, and the United Kingdom.

For the countries that allow investment in cryptocurrencies, taxation is one main concern. This requires the identification of how cryptocurrencies are being used and whether they are considered income or capital gains. Countries that are have imposed taxation on the use of cryptocurrencies include: Bulgaria, Switzerland, Argentina and Spain, Denmark, UK. Mining for cryptocurrencies however is not being taxed anywhere, except in Russia if energy consumption exceeds a certain threshold.

Some countries and jurisdictions have went a step further in allowing for the use of cryptocurrencies as means of payment. These include the Isle of Man, Mexico, Antigua and Barbuda and some Swiss Cantons. Lastly, a group of countries have launched their own cryptocurrencies or are planning to do so.

In conclusion, while the popularity and demand for cryptocurrencies is increasing globally, the economic, financial and social threats increase with the lack of regulation of this universal currency/commodity. Cryptocurrencies are criticized for allowing criminals to be involved in transactions and for tax evasion and money laundering through anonymous transactions. Numerous hacking incidents, money laundering and fraud incidents have been recorded in the past years resulting in losses of hundreds of millions of dollars, with no regulatory framework to track and sanction the anonymous responsible parties. On the other hand, the opportunities for countries to attract foreign direct investment and to create revenues from regulating cryptocurrencies are immense. Therefore, it is a responsibility for governments and central banks to be leading in the field of virtual currencies in order to regulate the market based on its terms and keep it a save platform for financial transactions.