Forum: Economic and Social Council

Issue #EC-02: The introduction and regulation of cryptocurrencies in the financial system

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Introduction

Cryptocurrencies (hereafter also referred to as CCs) are much more complex than a coin or an asset. Also known as “cryptos,” cryptocurrencies are digital payment systems which do not rely on banks for verifying their transactions. CCs only exist as digital entries to an online database known as the blockchain. The word's prefix ‘crypto’ comes from the use of encryption to verify the transaction CCs, and the aim of it is to provide security to its users/holders.

However, while security and anonymity may be what lures some users to CCs, it has made it increasingly challenging for governments to regulate transactions done in the blockchain, making it a perfect tool for criminal activity. Not only that, but CCs’ high volatility may have disastrous consequences that can spill to the rest of the financial system if the appropriate regulations are not in place. Governments now have to decide what their stance on cryptocurrencies is, and take action towards it before it is too late.

Definition of Key Terms

Legal tender

A legal tender is a country's official currency. For example, in the United States, the legal tender would be the US Dollar, and, in the case of China, the legal tender would be the Renminbi.

Encryption

Process in which data is converted into an unrecognizable form, only accessible via a decoding “key”. Encryption translates information using an algorithm that makes the original information unreadable.

Blockchain

System in which transactions made with cryptocurrencies are recorded around several computers.

Stable coin

A Stablecoin is a cryptocurrency whose price is determined by another more stable asset, such as a fiat currency or a property, etc.

Issue Overview

As said in the introduction, the problem with cryptocurrencies would be that while they rise, financial systems worldwide could destabilize. Hence, further action to prevent this from occurring is necessary.

What other problems do CCs represent?

Governments have also noticed that cryptocurrencies are increasingly being used to funnel money into criminal enterprises as they are harder to trace and regulate. Another problem crypto represent is their huge use of energy for getting to work the computers where their information is stored.

What benefits do CCs represent?

CCs do have an environmental benefit regarding any in-person currencies since they would produce fewer emissions and they wouldn't need to use many (if not none at all) natural resources.

What has been done?

As with most other issues, each country has tackled cryptocurrencies in different ways, but we can classify their approaches into three main categories:

Banning the use of cryptocurrencies

8 countries around the world, including China and Bangladesh, have chosen that banning cryptocurrencies is the best solution possible to this issue. Some of them would say they chose to ban cryptocurrencies due to their volatility and decentralization.

Regulating the use of cryptocurrencies

Most nations have decided to just regulate cryptocurrencies instead, as authorities agree that regulations will help protect investors' assets.

Making cryptocurrencies a legal tender

Until now only 1 country, El Salvador, has recognized a cryptocurrency (Bitcoin) as legal tender, but, in the near future, we may see more countries recognizing CCs as legal tender.

Latest events

NFTs

Even though cryptocurrencies and NFTs are different from each other, both use blockchain technology to store their data, so we can expect the rise in popularity of NFTs may bring with it further studies and upgrades to the blockchain.

Major Parties And Organizations Involved

USA

To date, the US has yet to adopt regulations on CCs at a federal level, leaving its regulation to each individual state. Even though they are not considered legal tender, they may be exchanged for US Dollars at any time. The SEC (Securities and Exchange Commission), America's main government agency when it comes to market protection, considers CCs a security. Meanwhile, the FinCen (Financial Crimes Enforcement Network), another government agency focused on financial crimes, considers cryptocurrency exchange as a money transmitter. Lastly, the Commodity Futures Trading Commission considers CCs to be a commodity. There is clearly discrepancies when it comes to cryptos, and those must be solved before any federal action is taken.

China

China is 1 of the 8 countries that fully banned CCs and their trade. The People's Bank of China called CCS a danger to the people's assets. At the time of the ban, China was one of the biggest CC markets. To illustrate this, the price of Bitcoin fell more than 2000 USD when the ban was announced.

India

India is the country with the most CCs holders throughout the world. At the moment there isn't a ban on CCs but the Indian government has taxed crypto activity. The RBI (Reserve Bank of India) called for banning any bank supporting CCs and their transaction was reversed by the supreme court in early 2020.

El Salvador

El Salvador was the first country in the world to adopt CC as a legal tender when it added Bitcoin as its official currency. President Nayib Bukele made Bitcoin a legal tender as a way of bringing more Salvadorans into the formal economy, given 70% of El

Salvador citizens do not have a bank account. Moreover, Bukele believes that using Bitcoin would be a faster and cheaper way to get remittances from abroad.

United Nations

The UN believes CC and the technology behind them (blockchain) can play an important role in sustainable development which could be mostly because of the natural resources they use for making bills/banknotes and coins (mostly trees for paper used on creating bills/banknotes, and metals for the coins).

IMF

The International Monetary Fund (IMF) has called for tougher regulation to prevent rapid cryptocurrency growth, as they think cryptocurrencies could lead to financial instability. The IMF is also aware of the risk of hacking the blockchain where cryptocurrencies information is stored which could lead to stealing owned CCs.

Timeline

Year	Event
1998	The term cryptocurrency was established
2009	The first cryptocurrency comes out (Bitcoin)
2010	Bitcoin’s first valuation
2011	Litecoin comes out (first Bitcoin alternative)
2013	China started cracking down on some CC-related activities

2016	Japan becomes the first country to introduce regulations for cryptocurrencies

Past Action

EU

The European Union has made rules for the use of blockchain to raise investments and secure investors' money. The EU has launched a 2-year investigation to launch a digital Euro and has proposed regulation on crypto assets in the best way possible.

Possible Solutions

Encourage fellow delegations to create their country's own CC in the format of a stable coin

Nations could implement their own digital version of their official currency and treat it as legal tender. This would allow their Central Banks to have total control over the currency, therefore allowing countries to keep their financial sovereignty. This would give countries control over the CCs which would be positive for the CC stability since that by being controlled by being attached to the country's legal tender. This would also mean that the coin could suffer from inflation and lose worth depending on its government ideas and actions.

Banning all external CCs

Nations could outright ban all CCs and their trade. They may also ban the blockchain system if they wish to avoid the risk of new technologies similar to cryptocurrencies from appearing in the future. This would help countries combat a way of money laundering since people couldn't buy CCs since buying and trading CC do need regulations for regulating who buys and trade CCs and that could mean time countries would need to invest, so by banning CCs countries would avoid both problems and by banning the blockchain system use they would avoid the similar problem on the future.

Require citizens to have a license for buying and exchanging CCs

Nations could have higher control over CC flow, particularly by demanding licenses for all national and/or international trade. This would help control who buys and trade CCs without banning them and losing the benefits CCs offer. This could also mean creating an institution or extending another institution so they could oversee all the stuff which relates to that CC license which could mean spending more money from the budget governments have.

Use a pre-existing CC as legal tender

Instead of implementing their own cryptocurrency, nations could treat a pre-existing CC as legal tender, as is the case in El Salvador. This could help countries fight the inflation issue if well done and wouldn't need countries and their treasure department/ministry to invest time on using blockchain system technology and learn how to use it since the CC exist before. The disadvantage of this resolution is mostly that countries wouldn't hold any power on this CC since they aren't owned by them.

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