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Recently, a government panel headed by senior bureaucrat Subhash Chandra Garg placed in the public domain a draft bill calling for a complete ban on private cryptocurrencies in India. The panel recommended a fine of up to 25 crore and a jail term of up to 10 years for anyone found to be owning or handling private cryptocurrencies. As an alternative to private cryptocurrencies, the panel recommended the introduction of a single cryptocurrency for the whole country that is backed by the Reserve Bank of India (RBI). Parag Waknis and Anil Antony examine the soundness of the panel's recommendations in a conversation moderated by ***Prashant Perumal****. Edited excerpts:*

Parag Waknis: Volatility doesn't sound like a good rationale to ban cryptocurrencies because if cryptocurrencies are volatile, so are many other asset classes. We do not ban investments in any other asset class just because it is volatile. The decision of whether to invest in an asset or not should be left to the investor. The risk return calculation should be done by the investor, not the government.

Also, banning the consumption of a good or service doesn't really mean that people will stop consuming it. The market for the good or service simply goes underground and becomes hard to track. The market continues to exist, but the government cannot track it or tax it to gain revenue. This applies to cryptocurrencies as well.

It is true that the price of cryptocurrencies, especially bitcoin, has been volatile. And that's primarily because of their design. Bitcoin, for example, is designed in such a way that its supply rises rapidly first, but later very slowly, before stopping at a certain point.

PW: Yes, exactly. In most cases, if the government feels that there is enough rationale to regulate the consumption of a commodity or a service or investments in a crypto asset, the best way forward is to come up with a regulatory framework that has incentives set right for the users. Maybe you can have a tax on capital gains from investing in crypto assets, just like you have taxes on investments in other assets.

The Garg panel, while being opposed to the idea of private cryptocurrencies, still seems to be a fan of the blockchain technology. It has called for a national cryptocurrency backed by the RBI, which would probably be based on the blockchain.

Anil Antony: The Garg panel opposing cryptocurrencies seems like yet another case of a group of people not really understanding a concept and hence trying to ban it. Most people equate cryptocurrencies with blockchain, but there is a huge difference between them. The cryptocurrency is just one application of the underlying blockchain technology. The blockchain technology has a lot more potential beyond cryptocurrencies.

PW: No. The way we define money is that it is a generally accepted medium of exchange. So, it's just trust that basically drives the value of money. There is nothing to back it, except trust. When two strangers have no other way of transacting with each other, when there's no way they can verify the creditworthiness of each other, money helps. That's all that we basically need. We need trust for that.

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Now, what does a crypto asset or a cryptocurrency offer? It is right that it is not backed by anything. But it doesn't really require any backing in the sense that, as long as people hold the expectation that a particular asset will have value, it is sufficient.

PW: Exactly. Yes. Cryptocurrencies allow people to conduct anonymous transactions. The price of bitcoin, for example, is driven by the access to the anonymity that it offers its users. People may also want to keep their wealth in some asset that gains in value over a period of time. So that is the worth or the "right" that people are paying for when they're buying cryptocurrencies.

There are also cases where fiat money has retained value even when the bank has ceased to exist. For example, in Somalia, the central bank and all the concerned institutions had ceased to work at some point. But people still continued to value the Somalian currency. So there was no backing at all for the currency, but people still believed that it had value and they continued to use the currency in transactions. So the strength of a particular asset boils down to what people think about it.

PW: I have done some research linked to this using money search models, where there is a set of competing monies, which could also be cryptocurrencies, and I basically show that there is a certain equilibrium where competing suppliers of cryptocurrencies would behave in a disciplined way. Theoretically, cryptocurrency providers could issue an unlimited amount of their money. But they're competing against each other, so the competition forces them to restrict their supply to a minimal amount that would help maintain the value of their currency. Thus the discipline imposed by market competition can prevent cryptocurrency providers from overissuing their currencies. We can also think about discipline in terms of reputation effects. For example, if there is a paper currency, and it turns out that it can be used to finance, let's say, crime, terrorism, or anything similar, there is the reputation of the supplier at stake.

So there are some ways by which the market can discipline cryptocurrencies. But I think regulation, in terms of having the right rewards and punishments in place, would help. Not actions like banning stuff.

AA: Just to add to this... right now, one of the most comprehensive sets of regulations surrounding this debate on cryptocurrencies being used for various nefarious activities is being discussed across the world. It is one of the biggest concerns everywhere. One of the most comprehensive sets of regulations for cryptocurrencies is being brought in by the European Union. The EU is putting in a bunch of regulations to tackle money laundering, and it is called the AMLD-5. It is a bunch of norms to make crypto transactions more secure. It has a lot of very stringent KYC regulations and self-declaration laws which every holder of a crypto wallet or user needs to adhere to. Crypto exchanges are all expected to maintain a database that is transparently shared between countries. It is not foolproof, but the EU has started creating a bunch of regulations that could become stronger over time. This could be the best way to go forward rather than putting a blanket ban on cryptocurrencies, because the presence of cryptocurrencies is very important for the further development of the blockchain.

AA: In 2018, in the Silicon Valley alone, almost $2.9 billion worth of private venture funds have gone into blockchain start-ups. In tech hubs across the world, we are seeing billions pumped into the blockchain technology. In this scenario, if we decide to put a blanket ban on all cryptocurrencies, then our technology entrepreneurs will suddenly lose the incentive to work in the sector. You simply can't just build blockchain applications out of thin air. Right now, currencies are the only viable practical application of the blockchain technology even though it can be extrapolated to a lot of other sectors. So, for the sake of innovation, I think even if the government is bringing in a state-backed currency, it will be better if the other currencies are also allowed to operate with sufficient regulations.

Also, when we are speaking about a country like India, in terms of size, cryptocurrencies constitute a very, very minor share of the total amount of money that is already being used to carry out various activities in the black economy. But the potential rewards that could come out of the blockchain technology are big.

AA: I would say nobody really expected cryptocurrencies to become such a big factor in such a short period of time. Right now, the global market capitalisation of cryptocurrencies is almost $120 billion. And that's just the tip of the iceberg, it could get way bigger over time.

PW: People will move to alternative assets and seek more anonymity only if they lose trust in government institutions. So, as long as the trust is maintained, monetary policy doesn't face any particular threat from cryptocurrencies.

When it comes to a central bank-issued digital currency, there is a loose consensus, especially among monetary economists from the New Monetary School, that there is no case for governments issuing cryptocurrencies because it would create a lot of problems in the form of contradictions in existing regulations and the government will have to deal with severe mismatches in regulations. Secondly, there are reputation effects. A digital currency issued by the RBI that gets misused by criminals can affect trust in the existing fiat currency protocol. I don't think a central bank would want to take that risk.

Parag Watkins teaches monetary economics at the Ambedkar Univesity, Delhi; Anil Antony is the convener of the digital media cell of the Kerala wing of the Indian National Congress.

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