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THE CRYPTOSPHERE NEEDS AMPLIFIED RISK WARNINGS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

RBI officials have done well to caution crypto enthusiasts by talking about tulip mania and Ponzi schemes. While the case for a digital-token ban remains weak, risk awareness must rise

Investors are always advised to look before they leap. For public offers of equity, this means that ‘risk factors’ listed in offer documents should be given a close read, at the very least. For crypto tokens, we have no formal equivalent. Hence, well-publicized cautions flagged by people in authority assume a vital role. In this context, the voices of our central bank’s top officials need to be amplified. Last week, Reserve Bank of India (RBI) governor Shaktikanta Das pointed out that typical crypto tokens have no underlying value to back them, “not even a tulip", a reference to the price bubble inflated by a speculative mania that had gripped 17th century Europe only to leave a trail of misery in its wake after it burst. This week, RBI deputy governor T. Rabi Sankar served up another analogy that rookie buyers ought to be familiar with. He likened crypto offerings to gambling contracts of the sort that form a “Ponzi scheme". This refers to a financial pyramid that uses funds put in by an expanding base of new ‘investors’ to assure a smaller group of earlier sign-ups big ‘returns’, a fraud that usually gets exposed once it runs out of gullible folks to lure, cash inflows fall short of promised payments and the whole thing collapses. What’s common to these examples is an abundance of money going into something that generates no value, an exercise that satisfies no need beyond the thrill of a casino-style gamble. To the extent that excess money plays a role, RBI is best placed to call out such dangers.

India’s central bank, however, is not a neutral observer of the crypto enthusiasm around us. The world’s best-known cryptocurrency, Bitcoin, was coined to supplant official currencies subject to value depletion through oversupply. Should digital coinages widely replace rupees as tokens of exchange, it would blunt our tools of monetary policy. While such an eventuality would endanger the management of our economy, this worry seems overblown right now because the cryptosphere is too crowded for any single ‘stablecoin’ to emerge as a credible usurper. Since this comfort could vanish in time to come, though, RBI cannot be denied its crypto anxiety. Its earlier move against digital upstarts was struck down by the judiciary, but the government may yet prove more receptive to its case for a crypto ban. The mere taxation of gains made on crypto trades, as imposed by the latest budget, does not grant the concept legitimacy, a point clarified by finance minister Nirmala Sitharaman. What’s taxable and what’s legal are in distinct domains of governance. American tax rules, for example, explicitly state that stolen money must be counted as income; the illegality of theft is another matter.

All this may suggest that a ban is imminent. According to Rabi Sankar, it can be done without any setback to other blockchain innovations. Yet, whether we should clamp down on crypto coins is a question that’s not so easily settled. Their most profound threat—of policy impairment—exists only in a distant realm. This peril can be minimized if RBI secures the status of our rupee by keeping inflation in control and deploying a digital version as a defence flank. A crypto ban would be hard to enforce, given the secrecy with which password ‘keys’ can be held. Moreover, why forgo a source of tax revenue? As for the losses that crypto bets could leave punters with, public warnings need to get even louder as super-cheap credit begins to reverse globally. Suitably alerted to risk factors, people should be left at liberty to buy the tokens they want. Caveat emptor.

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