Source : www.thehindu.com Date : 2021-11-26

# IS THE CRYPTO ASSET BOOM SUSTAINABLE?

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Public Finance, Taxation & Black Money incl. Government Budgeting

*One of the defining economic trends of the year has been the rise of cryptocurrencies. After the Supreme Court's decision last year overturning the Reserve Bank of India's 2018 order banning financial institutions from enabling cryptocurrency transactions, there has been a huge rush of retail investors into cryptocurrencies. Yet, the risk of the government cracking down on private currencies has remained. On Wednesday, the Centre announced that it will introduce a bill in the upcoming winter session of Parliament seeking to ban private cryptocurrencies, albeit with a few exceptions. Many commentators see the rise of cryptocurrencies as a bubble, while enthusiasts of cryptocurrencies see it as unstoppable. In a conversation moderated by* ***Prashanth Perumal J.****, Parag Waknis and Akshat Shrivastava discuss the government's move. Edited excerpts:*

**Parag Waknis:** Traditionally, gold has been one of the options for investors to not only hedge against inflation, but also against the risk that is inherent in any financial system. Now, cryptocurrency is another such asset that allows people to invest outside the traditional financial system. It is not regulated and its value fluctuates, probably more than gold. But as we have seen over the pandemic, it has offered phenomenal returns, much more than gold has been able to offer. It's always debatable whether the current valuation is the appropriate valuation or not. There are going to be disagreements about what should be the value of cryptocurrency. So, many people might call it just a bubble. But then, it doesn't have to be stigmatised just because it's a bubble.

Is the crypto asset boom sustainable? | The Hindu Parley podcast

**Akshat Shrivastava:** First and foremost, cryptocurrencies are an entire asset class, not just one asset. The primary advantage of cryptocurrencies is the mathematically designed blockchain network with finite supply. The primary problem with the current monetary set-up is that when the government starts printing more money, the value of your money gets wiped out due to high inflation. You can't do that with Bitcoin. So, cryptocurrencies give you a better hedge against inflation compared to gold by better ensuring limited supply. Gold has been a great asset in the past, but the supply of gold is not mathematically designed. So, Bitcoin is a sounder, fundamental currency. Second, there are systems and processes that can be developed around the blockchain network, such as decentralised finance systems. For example, when you transfer money to your friend in the U.S., there are significant charges that you incur if you go via any major bank in India. It's a friction that can be eliminated by the use of technology.

**Parag Waknis:** Blockchain technology itself has great potential to reform financial record-keeping and keeping track of asset transactions. So, that is one major use of blockchain technology. Now, when it comes to currency as such, cryptocurrencies are more like hedge assets. So, cryptocurrency is equivalent to gold. We do not expect people to walk into a store and directly use cryptocurrency to buy goods and services. Cryptocurrencies still have to be converted into some actual currency that can be used. We do not quote prices in terms of Bitcoins. Governments do not accept taxes in Bitcoin or Ethereum. So, the word currency is a misnomer. But what gives cryptocurrencies as assets an advantage over cash or fiat money is the fact that they exist outside the purview of the government. In the days just after demonetisation, people looked to invest in cryptocurrency. When people see that the value of a particular asset can be wiped out overnight by a government diktat, that is enough to create some amount of distress trust in the good. Most of the investments after demonetisation have been in real assets. So, cryptocurrencies may not have immediate use in terms of going into a store and buying something but they are basically a hedge against any system-wide action that can wipe out the value of any particular asset.

**Akshat Shrivastava:** Right now there are more than 20,000 businesses that are accepting Bitcoin. People can buy a bunch of digital products using Bitcoin. If you move to certain countries, you can transact in fractional values of Bitcoin. So, there is no problem in terms of transacting in Bitcoin. In fact, you can't go to Starbucks and pay in gold to buy a coffee. That is not possible.

'Survey suggests 71% have low or no trust in cryptocurrency'

Second, there is something fundamentally off in how the monetary system currently works. Economists would say that fiat money is a store of value and a medium of exchange. Is fiat money a medium of exchange? Yes, it's a very good medium of exchange. But is the current fiat money a store of value? Absolutely not. The reason why Bitcoin became prominent was that the value of fiat currencies was being eroded systematically. Right from 2008, due to quantitative easing, money supply was increasing and every time the government turned on the money-printing machine, the value of the money that you saved went down. So, people started looking for better alternatives where one cannot create money at their own will and potentially wipe out your savings. The fundamental value of Bitcoin is that it is a great store of wealth.

**Akshat Shrivastava:** It depends on how you're defining it. For example, if you're defining cryptocurrencies as an asset class, then they are competing against something like gold, not against fiat money. If you actually structurally understand this entire problem, the U.S. dollar is going to be the biggest beneficiary from this entire crypto movement. There is a reason why senators in the U.S. are accepting their salaries in Bitcoin. By the end of this year, a substantial share of the U.S. population will have some sort of cryptocurrency in their wallets. Jamie Dimon of JPMorgan Chase and Ray Dalio were both crypto critics at the beginning, but they have now come to embrace it. The adoption of cryptocurrencies, especially Bitcoin, has been the fastest adoption of any technology. It is literally changing the way you're interacting with technology. If you say that you are going to ban Bitcoin, or that you are going to ban Ethereum, then the bottom line is that you're actually saying no to a big part of technology that can prove to be revolutionary. Think about it this way. For example, if India decides to ban Ethereum, we would have essentially said no to the entire decentralised finance system, because no other developers will come and build a blockchain network for you and power it up for you. It's like saying a government has the potential to beat Facebook in terms of building a social media network.

Government to change tax laws in Budget to tax cryptocurrency gains

**Parag Waknis:** It's wrong to ban any asset unless there are compelling reasons. And I do not really find any compelling reason in this particular case. You are basically going to create an underground market. And people will continue to invest in crypto assets. It will be hard to regulate. It would probably increase the penalty cost and more risk-averse investors would be dissuaded from investing. But overall, other than the desire for complete control over the monetary system, I don't see any other motive or economic rationale for banning crypto assets. So, the government should not do it. In fact, it should build a proper regulatory framework and allow investment because it's like any other asset. Then there are great benefits to the blockchain network itself that the government can use for financial record-keeping. It's antithetical to say that the government will ban the private crypto network and come up with its own crypto network because the whole idea of a crypto network is having a decentralised record-keeping system, and the government having monopoly over a decentralised record-keeping system does not make any sense.

**Parag Waknis:** Private currencies could have a beneficial effect in disciplining the central bank. In Zimbabwe, for example, the government printed a lot of money and then the currency lost value. People then moved to the U.S. dollar for transaction purposes. This in turn forced the Zimbabwean government to enact some monetary reforms, curtail the supply and have some kind of a benchmark to the U.S. dollar so that the Zimbabwean dollar could regain the ground that it had lost because of increasing supply. So, one of the beneficial effects of competing currencies is the disciplining effect it has on the central bank or on fiat money. Governments cannot just willy-nilly keep increasing the money supply since people will then always have the option to shift to other payment instruments. This was the classic dilemma that Milton Friedman actually posed, that we kind of accept that monopoly is bad in most cases in the economy but we kind of take the monopoly power of the central bank for granted without questioning it. There are examples in history where private banking notes have functioned very well and there are examples where they have failed too. There is a lot of research that goes into why they were successful and why they failed. But overall, it seems that if a private currency has certain characteristics such as scarce supply that is guaranteed, a criterion that many cryptocurrencies satisfy, then it could actually perform as a competing payment instrument that could discipline the central bank. There are plenty of historical examples for this. No single instrument can have all the advantages anyway. But every payment instrument comes up with some advantage and some disadvantage. So, we can kind of figure out which technology or which currency works better for what purposes and then think of some way of creating a financial system which harnesses all these new instruments, rather than cracking down on them.

Sydney Dialogue | Democracies must ensure cryptocurrencies don't end up in wrong hands: PM Modi

**Akshat Shrivastava:** The current monetary set-up has serious flaws. That is the primary reason why cryptocurrencies have grown at such a massive scale. The adoption of cryptocurrencies has been one of the fastest for anything in technology ever in human recorded history. There are massive pitfalls in how the current monetary set-up is managed. Every time there is a problem, the solution is to print massive amounts of money, and every time the government prints money, it creates irreparable damage to people, especially at the bottom end of the society. That's point one. Second, money printing is not an economic question. It's a political question. There is always more demand among governments to spend than the supply of funds available. And in order to satiate that demand, more money is printed. If people understood this economic concept they would be demonstrating on the streets.

*Akshat Shrivastava is a serial entrepreneur and an investor in cryptocurrencies; Parag Waknis is an Associate Professor at Ambedkar University*

**Our code of editorial values**

Sri Lanka's decision to ban imports on chemical fertilizers was not backed by scientific evidence

**END**