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| 5 | Cryptocurrency is currently at the frontier of financial development. It provides both opportunities and risks in financial markets and has attracted significant attention in recent years. Accordingly, the number of market players involved in the cryptocurrency business has risen (Farell 2015). The new business model provided by cryptocurrency along with the exponential increases in the prices of cryptocurrency may have enticed investors toward cryptocurrency, with many utilizing cryptocurrencies as a speculative asset to take advantage of the early gains. However, the subsequent crash in prices acted as a wake-up call to speculators dealing with cryptocurrency. Additionally, risks related to price manipulation in cryptocurrency markets are not unheard of (Gandal et al. 2018).  Although many central banks issue warnings about the use of cryptocurrency and have explicitly denied its status as a currency, only a few have banned its use as a financial asset. Policy makers are concerned about the low liquidity, the use of leverage, market risks from volatility, and the operational risks of cryptocurrency (FSB 2018). Many central banks emphasize that cryptocurrency is not legal tender and that users face the risk of unenforceability of cryptocurrency transactions. The Global Research Center (2018) compiled regulations on cryptocurrency and its report shows that, in countries where cryptocurrency is allowed, it can be legally traded as long as it follows existing rules or laws related to financial instruments. Regardless of the regulatory stance, policy makers are wary that cryptocurrency would be used for illegal activities, such as money laundering, trade in illegal or controlled substances, or terrorism finance. Policy makers are also aware of the potential lack of consumer and investor protection. Deposit insurance for holders of cryptocurrency is limited and not supplied by domestic monetary authorities. The combination of its potential benefits as well as macroeconomic risks begs the question of what determines policy openness or aversion to cryptocurrency.  Research on cryptocurrency encompasses several fields of study, from economics and finance to computer science and engineering, as well as applied mathematics. The breadth of the research field is not surprising given the nature of cryptocurrency as a financial innovation with its roots in blockchain technology and the fact that it uses cryptography intensively. Farell (2015) provides a brief historical background to cryptocurrency and discusses the security networks used by major cryptocurrency providers and the implications for the cryptocurrency industry. DeVries (2016) presents an examination of the bitcoin market and industry players using a SWOT (Strengths, Weaknesses, Opportunities, and Threats) framework, which is a common management analysis tool. Recent economic literature on cryptocurrency delves into issues such as determinants of cryptocurrency prices (Liu and Tsyvinski 2018; Corbet, Lucey, and Yarovaya 2018), cryptocurrency exchange rates (Li and Wang 2017), and persistence in the cryptocurrency market (Caporale, Gil-Alana, and Plastun 2019; Bouri et al. 2019), among other things. To date, there are no studies specifically investigating the factors influencing the policy stance on cryptocurrenc |  |
| 7 | Cryptocurrency is an electronic token, which originates from the need for direct peer-to-peer online payments (Peters et al. 2015). The most widely used and known cryptocurrency is bitcoin, introduced by an unknown developer or a group of developers with the pseudonym Satoshi Nakamura. It uses a decentralized public ledger to record ownership and transfers of value. The innovation behind cryptocurrency is that transactions are verified by several “miners,” who solve a complicated cryptographic problem to verify the ownership of the cryptocurrency and the subsequent transfer. The miner who solves the cryptographic problem first and validates the transaction receives cryptocurrency as remuneration. The mining process is an opensource program that can be accessed by the public. The peer-to-peer verification system bypasses typical trusted third parties such as a bank or a credit card company. Various innovations in cryptocurrency have emerged since bitcoin rose to popularity, thereby broadening the definition of cryptocurrency. While some central banks are mulling over establishing their own cryptocurrency, the industry is mainly a market-driven phenomenon  Cryptocurrency in its current state is not considered a substitute for money. One of the largest points of contention regarding its value comes from the fact that it is not issued by any sovereign authority, thus its intrinsic value is questionable. Money has three basic features—a unit of account, a generally accepted medium of exchange, and a stable store of value. Cryptocurrency cannot take the role of a unit of account and a store of value because the market valuation of cryptocurrency is characterized by large volatility in prices. Bitcoin, the largest cryptocurrency in terms of market capitalization (Coinmarketcap.com 2017), saw its value rise in December 2017, before subsequently losing 30% of its value in December 2018 (Kollewe 2018). The unenforceable nature of cryptocurrency transactions in many countries also prevents it from becoming a common means of payment.  they can potentially reduce the cost of international transfers, including remittances. Lower transaction costs can ultimately contribute to financial development and increased financial access. Thus, while the large uncertainty over the value of cryptocurrency currently prevents it from being recognized as a currency that functions as a unit of account or a store of value, it is largely used for payment that promises anonymity and the elimination of intermediation costs  As cryptocurrency gained more recognition in the financial sector, market players began to use it as a speculative investment asset. Similarly to other financial instruments, cryptocurrency began to be traded in cryptocurrency exchanges. Baur, Hong, and Lee (2018) found that bitcoin, holding the largest share of the cryptocurrency market, is mainly used as a speculative instrument rather than an alternative currency. Speculative trading is conducted in exchanges where consumers can buy, sell, and exchange cryptocurrencies using dollars, euros, or yen, or other cryptocurrencies. Currently, over 200 exchanges support cryptocurrency trading all over the world (Hansen 2018). The major exchanges are located in countries such as, the US, the Republic of Korea, and Samoa, among others (Hansen 2018). |  |
| 8 - 9 | the policy stance on cryptocurrency among countries remains heterogeneous, with some countries being open to its use, silent in terms of regulation, or explicit in its prohibition. The Global Legal Research Center (2018) provides a comprehensive report on the legal and policy landscape surrounding cryptocurrency. While some countries ban cryptocurrency outright (Nepal, Pakistan, Viet Nam, etc.), most countries neither regulate nor promote it. Italy, Australia, and Japan, among other countries, require the registration and licensing of cryptocurrency operations. Meanwhile, the report shows that the Isle of Man and Mexico allow the use of cryptocurrency as a means of payment  Uncertainty over security, the legality of its transactions, and the extent of consumer and investor protection has kept policy makers wary about its operations. Because of this, many central banks around the world try to inform the public about the difference between legal tender, which is backed by their central bank, and cryptocurrency, which is neither backed by the domestic nor other foreign monetary authorities. Furthermore, the combination of the speculative nature of cryptocurrency and its lack of supervision poses a threat to both investors and consumers. Although the cryptocurrency market itself is not large enough to pose a global risk at this time (FSB 2018), it may still pose risks to consumers and investors in smaller countries where cryptocurrencies are being used.  For countries where cryptocurrency transactions take place, policy makers also need to consider other policy or legal issues. In particular, the anonymous nature of cryptocurrency leads to concerns about using it to finance illegal activities such as trade in illegal substances, tax evasion, and financing of terrorism. Thus, particular regulations are put in place on top of existing laws on commercial activities. The Global Legal Research Center (2018) reports that the Republic of Korea, for instance, prohibits the use of anonymous bank accounts in cryptocurrency trading. The government of the Republic of Korea also requires banks to report activities deemed suspicious under the regulations in its thrust to prevent money laundering. In addition, the report shows another example of cryptocurrency regulation with the licensing requirement of Israel’s Supervision of Financial Services for financial asset service providers, which includes virtual currency  (...) the Global Legal Research Center (2018) reports that Japan revised its regulations on cryptocurrency to respond to the increasing speculation in the market. In April 2017, Japan revised the Payment Services Act to explicitly define cryptocurrency and to require the registration of dealers who exchange cryptocurrency with legal tender such as yen (Jiji 2018). In March 2018, Japanese regulators issued business improvement orders to cryptocurrency exchanges as a response to the incident when Coincheck, one of the biggest cryptocurrency exchanges in Japan, lost about $400 million in cryptocurrency.(...)  In contrast, some policy makers decide not to regulate cryptocurrency specifically and allow existing laws on commodities or financial instruments to govern the use of cryptocurrency. The regulations compiled by the Global Legal Research Center (2018) present several examples. Austria considers cryptocurrency to be a business asset, classified under other intangible commodities. The Czech Republic similarly considers cryptocurrency to be a commodity, which explains their “liberal approach” to cryptocurrency, essentially neither promoting nor hindering its development as they would do in other commodity trading. Australia sees cryptocurrency as assets for the purpose of capital gains tax. Anguilla treats cryptocurrency that functions as securities to be regulated under the existing securities framework. Meanwhile, some other countries, such as Bermuda and the Bahamas, currently do not have specific regulations on cryptocurrency and are in the process of exploring their regulatory or legislative options. |  |
| 9 | The risks of cryptocurrency are undisputed but the policies toward it vary widely. With its increasing presence in financial markets, cryptocurrency cannot be ignored, particularly by policy makers. Policy makers have been vocal about giving warnings but not all have been active in banning or regulating it. Even the policy choice of no regulation is a policy decision in itself in that policy makers are not prohibiting, but essentially allowing people or firms to engage in cryptocurrency transactions at their own risk  We posit that the characteristics of government institutions can also influence the policy stance taken toward cryptocurrency. In particular, we test whether effective governance is more likely to be supportive of financial development as characterized in this paper by a less restrictive stance to a burgeoning cryptocurrency industry. Nee and Opper (2009) show that the quality of the state bureaucracy can contribute to financial market development. They argue that financial markets develop when institutions provide a stable environment where risks can be calculated. Enforcing contracts and protecting property rights can foster the confidence of economic actors. In particular, they emphasize the importance of credible, predictable, and reliable support from the public administration in facilitating the development of the securities market where control and ownership are separated |  |
| 14 | Therefore, the results show that the quality of legal system and institution strongly relates to the attitude of policy makers toward the cryptocurrency liberalization. In other words, cryptocurrency is less regulated when the legislation is more refined and sophisticated  economic development has a negative effect on the development of cryptocurrency since a percentage change in real income per capita decreases the probability of full cryptocurrency liberalization by 26 percentage points  This study reaffirms previous findings that institutional quality contributes to financial development even after taking into consideration factors such as de jure financial openness, economic development, inflation, and trade openness, which may also influence the decision of policy makers to be open to cryptocurrency. Putting it differently, the results imply that a certain level of institutional quality may be necessary before opening up to new forms of financial technology. Cryptocurrency in particular is recognized as a risky speculative financial instrument. Its current state of many unknowns can also prevent policy makers from conducting a thorough surveillance to avoid system-wide vulnerabilities.  the decentralized and international nature of the cryptocurrency industry underlies a need for international cooperation. Standing issues include avoiding potential circumvention of regulation and supervision in the international trade of cryptocurrency, particularly for preventing money laundering or terrorism finance. Policy makers also need to be wary of potential spillover effects of volatility in the cryptocurrency market. |  |