Will Regulation Facilitate The Demise of Crypto?

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Introduction

At the dawn of civilization, people struggled to find ways to exchange value for other goods. First, they tried to barter for services, but found that to be inefficient. Subsequently, items that stored "value" were used to conduct commerce. In the millennium since, the world has graduated to precious metals such as gold and silver, and most recently to paper money as the ruling medium of exchange. However there has never been a currency that has been universally accepted and permanent.

Paper money has been proven effective across centuries now, but it is not without its faults. For one, it lacks intrinsic value; if the world one day decided to no longer accept it in exchange for goods and services, there would be no other value that paper money could provide for us. As for its other issues, paper money can be inconvenient to carry at certain volumes, it's very centralized, susceptible to rapid inflation, and more. Enter cryptocurrency.

In the modern, chaotic, and ever-changing world that we live in, many have been led to believe that the era of paper money is on its last legs. They believe the next step for the world economy is through digital currencies - many of which already exist today - called cryptocurrencies. However, is crypto the answer? Many questions surrounding the changing regulatory environment for crypto, countries adopting cryptos to use as their national currency, war donations being made with crypto, and the wholesale ban of crypto transactions and wallets in some countries has raised questions regarding how crypto's place and longevity will hold up in an evolving regulatory world.

Cryptocurrencies' deep integration into monetary systems, unique technological qualities, and widespread use adoption suggests that cryptocurrency will have a larger role to play in future global and local economies. Part I of this paper will explore what cryptocurrencies are in their simplest form and how they differ from any alternative forms of exchanging value. Part II explores the plethora of use-cases for crypto. Part III outlines crypto's performance in regulated versus unregulated environments.

Part I: Crypto Regulation Background and History

Beginning in the 1990s, attempts were made to create a way to digitally exchange value, including the initial E-Cash technology. It was not until Satoshi Nakomoto introduced bitcoin in 2009, that the idea of a cryptocurrency that could stand along with reliance on any bank or central authority. After the creation of bitcoin 13 years ago, the crypto world has expanded from one platform to over 19,000 tokens available for trade today. Now, many cryptocurrencies are used to exchange value online for goods and services. Other technology has been developed that also utilizes the blockchain technology such as Non-Fungible Tokens (NFTs), direct peer-to-peer payments, and investing in other cryptocurrencies.

A defining feature of most cryptocurrencies is that they are decentralized, meaning they are free from the control of one central bank or governmental treasury who would seek to manipulate the token supply. The value from this decentralized feature can be easily highlighted by looking at the world we live in today. Currently, due in large part to COVID, war, and the ripple effects stemming from these events, many economies around the world are suffering from the devastating impact of rapid inflation. Because people were harmed by COVID and the effects of war, countries were forced to print more money in order to ensure the health and safety of their citizens. However, as one might learn in any economics class, when a government prints money at a very fast rate, prices go up faster than wages can catch up to them, leading to a point at which a formerly average sum of money is now rendered worthless. Decentralized currencies solve this issue, since they prohibit central authorities from rapidly deploying funds into their ecosystem and decreasing the value of the currencies. Instead, cryptocurrencies are kept alive by the free flow of the marketplace. The values are realized by the amount of users, how much people are paying for a single token, and the economic activity being conducted in the coin's ecosystem rather than any government or tyrant deciding the trajectory at which the currency will thrive.

Regulation has limited crypto's ability to be completely decentralized. Many countries have regulated cryptocurrency for a variety of reasons. At first, countries didn't deem crypto important enough to regulate, but that changed as recently as 2013. Some countries, including Algeria, China, Bangladesh, Bolivia, Colombia, Ecuador, Egypt, Indonesia, Iran, Nepal, and Taiwan have completely restricted the use of cryptocurrency in the past.[1]

However, many countries have worked in the opposite fashion, opting to work with crypto, rather than against it. Not all regulation is negative and meant to prohibit the usage of cryptocurrency. Japan became the first country to regulate crypto in 2016 after a series of large-scale hacks against crypto exchanges.[2] In doing so, they declared Bitcoin "legal tender for payment in Japan," as well as began requiring virtual currency exchange platforms to register

[1] "The Evolution of Cryptocurrency and Regulations since the Inception of Bitcoin." *ETN-Network Press Room*, Prezly, https://news.electroneum.com/the-evolution-of-cryptocurrency-and-regulations-since-the-inception-of-bitcoin.

[2] "The Evolution of Cryptocurrency and Regulations since the Inception of Bitcoin." *ETN-Network Press Room*, Prezly, https://news.electroneum.com/the-evolution-of-cryptocurrency-and-regulations-since-the-inception-of-bitcoin.

with authorities.[3] Part of the reason that most countries do regulate it in some form is due to their desire to further "centralize" digital ecosystems and exercise control over cryptocurrencies. For instance, Russia has begun to regulate crypto, though not completely, for fear it could pose a threat to their central banks' control over monetary policy.[4] Alternatively, American legislators have discussed new policies that would allow institutions to work with crypto, more than limit it. The legislators are now working to make crypto trading histories more public to banks and government agencies, in order to make it taxable and safer for traders.[5]

Part II: Evolutions in Crypto Regulation

Overall, most countries have exhibited relatively positive, non-hostile responses to the rise of cryptocurrencies, which could enable the citizens of those countries to increasingly use crypto. Rather than trying to regulate them out of existence, governments have been working to institutionalize crypto and allow economies to grow with it. The institutionalization of crypto should add confidence in investors to trade crypto after further acknowledgement and regulation by their local governments. This added use will hopefully cause a ripple effect that will lead to more investment from institutional investors.

Not all regulation is meant to "inhibit" crypto's capabilities or accessibilities. For example, Japan, who initially took a tax and regulation-heavy stance on crypto, has recently

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[3] "Japan's History of Crypto Asset Regulation: 2014-2020." *Sygna*, 31 May 2020, https://www.sygna.io/blog/japan-crypto-regulation-history-2014-2020/#:~:text=2016%3A%20Japan%27s%20PSA%20recognizes%20Bitcoin%20and%20crypto%20as%20legal%20tender,of%20crypto%20regulation%20in%20Japan.

[4] Nabben, Kelsie. "Cryptocurrency Has an Impact on Economies. That's Why Some Are Afraid of It – and Some Welcome It." The Conversation, 31 Jan. 2022, https://theconversation.com/cryptocurrency-has-an-impact-on-economies-thats-why-some-are-afraid-of-it-and-some-welcome-it-175911.

[5] Bonaparte, Yosef. "How Regulation Sentiments Influence Cryptocurrency? Is Crypto a Wall Street Darling?" *SSRN Electronic Journal*, 2022, https://deliverypdf.ssrn.com/delivery.php?ID=324008102071120087118121007097082092127013047085066030022005029120125107111115126108121034058014030047028082098017083087082072058066022051042124012095123072074065031069004099017120028095000022095114101024066113075075066010114022093028076103103031094&EXT=pdf&INDEX=TRUE.

announced plans to actually incentivise activity in crypto markets by granting tax benefits to both corporate and individual investors who invest in crypto. This new proposal comes as part of the Japanese government's new plan to reinvigorate the world's 3rd largest economy by incentivising economic activity across the board.[6] In a similar vein of making crypto more safe and accessible, the Australian government recently began their initiative of "token-mapping," in order to track every crypto token or asset on the market and promote public trade. Additionally, the Australian government will now require increased insight from creators into their products being put on the market.[7] This initiative is designed to prevent investors from investing in scams or unsafe tokens. Cooperative regulatory approaches like these are also being adopted by other countries, who seem keen to regulate crypto in a way that will make it easier for the public to access, rather than harder.

There are some potential downsides that experts have noted in regards to regulating crypto. For one, many feel that regulation may obstruct innovation in the space. If governments make it less accessible or adaptable, the crypto universe could become less of an expansive spectrum of opportunity and more a technology molded to the regulation constraining it. Another sacrifice in regulating crypto is that decentralization may be compromised. Decentralized finance and banking systems are a large draw for many into the crypto space, but in a regulated setting, this dream is put to sleep to a large extent. If governments can regulate the technology however they want, how decentralized can a blockchain really be? Since much of crypto's mere existence

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[6] Marquez, Reynaldo. "Why Japan Could Ease Crypto Rules to Revitalize Economy." *Bitcoinist.com*, Nexo, Aug. 2022, https://bitcoinist.com/japan-ease-crypto-regulations-to-revitalize-economy/.

[7] Bettes, Kate. "What Will Australian Regulation Mean for Cryptocurrency?" *UNSW Newsroom*, 26 Aug. 2022,
https://newsroom.unsw.edu.au/news/business-law/what-will-australian-regulation-mean-cryptocurrency.

is built around the value of decentralization, a regulated "crypto-currency" could be a tough obstacle for many personal investors to overcome.

Regardless, it is impossible to create a true centralized cryptocurrency because that creation defeats the purpose of cryptocurrency, which is to provide a decentralized platform to transfer value. Cryptocurrency will likely never exist in a centrally regulated form, but rather a decentralized form that countries will always look to regulate and/or control in their marketplaces. Ultimately, there will never be a purely decentralized cryptocurrency in the truest sense of the word because governments will always regulate it in some way. While a regulated decentralized cryptocurrency is tolerable and usable in some way, it may be hard for some investors to swallow the pill of regulation and feel inclined to heavily invest in crypto opportunities.[8]

However significant some may believe these downsides to be, the good outweighs the bad. Regulation is the step that most countries and institutions need to feel secure fully accepting crypto into their marketplaces. This regulation is definitely worth the price, and is often a net-positive on society. Historically, regulation has come not only with acceptance, but opportunity. As Kelsie Nabben put it, "Past examples suggest countries that welcome crypto networks reap economic benefits through innovation, investment, jobs and taxes. Business benefits of adopting crypto as a digital asset include access to new demographics and technological efficiencies in treasury management."[9]

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[8] Nabben, Kelsie. "Cryptocurrency Has an Impact on Economies. That's Why Some Are Afraid of It – and Some Welcome It." The Conversation, 31 Jan. 2022, https://theconversation.com/cryptocurrency-has-an-impact-on-economies-thats-why-some-are-afraid-of-it-and-some-welcome-it-175911.

[9] Nabben, Kelsie. "Cryptocurrency Has an Impact on Economies. That's Why Some Are Afraid of It – and Some Welcome It." The Conversation, 31 Jan. 2022, https://theconversation.com/cryptocurrency-has-an-impact-on-economies-thats-why-some-are-afraid-of-it-and-some-welcome-it-175911.

While the debate rages on, the good news is that studies show that whether or not crypto is regulated has not historically had as much of an influence on pricing throughout the markets as some might initially think. According to Bonaparte, while the regulations can then be followed by a slight drop in price in the short term, there is an idea that perhaps the negative news will not always have a negative effect, and may even lead some investors to continue holding crypto, due to the added layer of security they may feel. It is, however, worth noting that regulations have had an effect on market volatility as more news continues to break.[10]

Conclusion

Regulation will determine whether or not crypto markets will thrive or fail going forward. While regulation does have some drawbacks, namely the sacrifice of "decentralized finance," it ultimately serves to further normalize crypto throughout countries, institutions, and households around the world. Not only will regulation allow entities to make crypto transactions safer, they will also make them more accessible and a part of everyday life. Furthermore, in addition to regulation expanding crypto's role in society, regulation has not historically been the sole driver behind cryptocurrencies' market's value. Given these two key points, while it is inevitable that crypto will be regulated and institutionalized, this regulation in and of itself may not lead to the downfall of crypto. Ultimately, it will be how this regulation is structured and how governments implement it that will drive the future use of cryptocurrencies.

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[10] Bonaparte, Yosef. "How Regulation Sentiments Influence Cryptocurrency? Is Crypto a Wall Street Darling?" *SSRN Electronic Journal*, 2022, https://deliverypdf.ssrn.com/delivery.php?ID=324008102071120087118121007097082092127013047085066030022005029120125107111115126108121034058014030047028082098017083087082072058066022051042124012095123072074065031069004099017120028095000022095114101024066113075075066010114022093028076103103031094&EXT=pdf&INDEX=TRUE.