



Cryptocurrency

For Prelims: Cryptocurrency, Bitcoin, Blockchain

For Mains: Cryptocurrency & Related Issues, Government Policies & Interventions

Why in News?

Recently, the **Central African Republic (CAR)** became the second country after El Salvador to adopt [Bitcoin](#) as legal tender.

- The [Union Budget 2022-2023](#) of India has also proposed to introduce a digital currency in the coming financial year.
- It was also announced that “any income from transfer of any virtual digital asset shall be taxed at the rate of 30%.”

What is Cryptocurrency?

- [Cryptocurrency](#), sometimes called crypto-currency or crypto, is any form of currency that **exists digitally or virtually** and uses cryptography to secure transactions.
- Cryptocurrencies don't have a central issuing or regulating authority, instead use a decentralized system to record transactions and issue new units.
 - It is supported by a decentralized peer-to-peer network called the [blockchain](#).

What are the Benefits Associated with Cryptocurrency?

- **Fast and Cheap Transactions:** Cryptocurrencies are way cheaper to use to execute international transactions because the transactions don't have to be handled by a series of intermediaries before they reach their destinations.
- **Investment Destination:** There is a limited supply of cryptocurrency – partially like gold. Moreover, the last few years have seen the price of cryptocurrencies rising faster than other financial instruments.
 - Due to this, cryptocurrencies can become a preferred investment destination.
- **Anti-Inflationary Currency:** Due to the high demand for cryptocurrency its prices have largely remained on a growing trajectory. In this scenario, people tend to hold more cryptocurrency than spending it.
 - This will cause a deflationary effect on the currency.

Why are Countries like CAR Adopting Cryptocurrencies as a Legal Tender?

- **Strong and Inclusive Growth:** The measure would enable “strong and inclusive growth” and place the African country on the “map of the most courageous and visionary countries in the

world”.

- Having a population of 5 million, CAR is **among the poorest and most economically fragile countries globally**.
 - As per the World Bank estimates provided in July 2021, 71% of its population was living below the international poverty line of USD 1.90/day.
- **Positive Growth:** There is potentially a direct relationship between inflation and countries permitting the use of cryptocurrencies.
 - Cryptocurrencies bear the potential to **convert inflation-related decline from legal currencies into positive growth**.
 - This potentially direct relationship would be relevant for CRA. As per the IMF, inflation in the country is **expected to accelerate to 4% in 2022** because of rising food and fuel prices.

How is this About Geopolitics?

- **Dependency on the Other Country:**
 - The two countries that regularised Bitcoin as a legal tender **do not have a currency of their own**.
 - El Salvador uses the US dollar and CAR's franc is the mutual currency for 14 African nations. Together these countries—most of which were once French colonies constitute the '**Franc Zone**'.
 - Franc can be exchanged into foreign currencies via the exchange market of Paris which creates a dependency on the European country.
- **Circumvent the Sanctions and Embargos Imposition:**
 - As a consequence of the blockade imposed by the U.S., countries such as **Cuba are cut off from global financial systems** and cannot acquire financial instruments such as debit or credit cards, in turn, struggling to go abroad and obtain materials and services from outside.

What are the Drawbacks?

- **Extremely Volatile:** Cryptocurrencies are highly volatile assets and have acquired popularity for their unregulated nature and the risk of volatility has established concerns over the potential impact on a country's macroeconomic stability, especially those with weak socio-economic fundamentals.
 - Recently, several countries have considered **instituting laws that regulate the use of cryptocurrencies**, particularly those not having well-devised currency mechanisms and experiencing prolonged inflation.
- **Unregulated Nature:** [International Monetary Fund](#) (IMF) had also urged El Salvador to limit the scope of unregulated assets as there are large risks associated with the use of Bitcoin on financial stability, financial integrity, and consumer protection, as well as the associated fiscal contingent liabilities.
- **Paying Taxes in Cryptocurrencies:** For countries like CRA, risks associated with paying taxes in cryptocurrencies would be exposed when taxes are paid using crypto assets but expenditures remain in local currency.
 - For example, the government collects \$100 worth taxes using crypto denominations, but a downward slide of the asset makes available \$40 to spend.
- **Not a Definite Mechanism:** Unlike equities or currencies, cryptos are not subject to a definite mechanism and are speculative assets, therefore, central banks would not have any reference point to devise their interest rates in accordance with their domestic requirements.
- **Counterproductive Utility:** Blockchains may help trace the transactions but not the parties involved. Hence, it could potentially be used for money laundering, terrorist financing, or other illegal activities.

UPSC Civil Services Examination, Previous Year's Questions (PYQs)

Q. With reference to 'Bitcoins', sometimes seen in the news which of the following statements

is/are correct? (2016)

1. Bitcoins are tracked by the Central Banks of the countries.
2. Anyone with a Bitcoin address can send and receive Bitcoins from anyone else with a Bitcoin address.
3. Online payments can be sent without either side knowing the identity of the other.

Select the correct answer using the code given below:

- A. 1 and 2 only
- B. 2 and 3 only
- C. 3 only
- D. 1, 2 and 3

Ans: B

[Source: TH](#)

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