

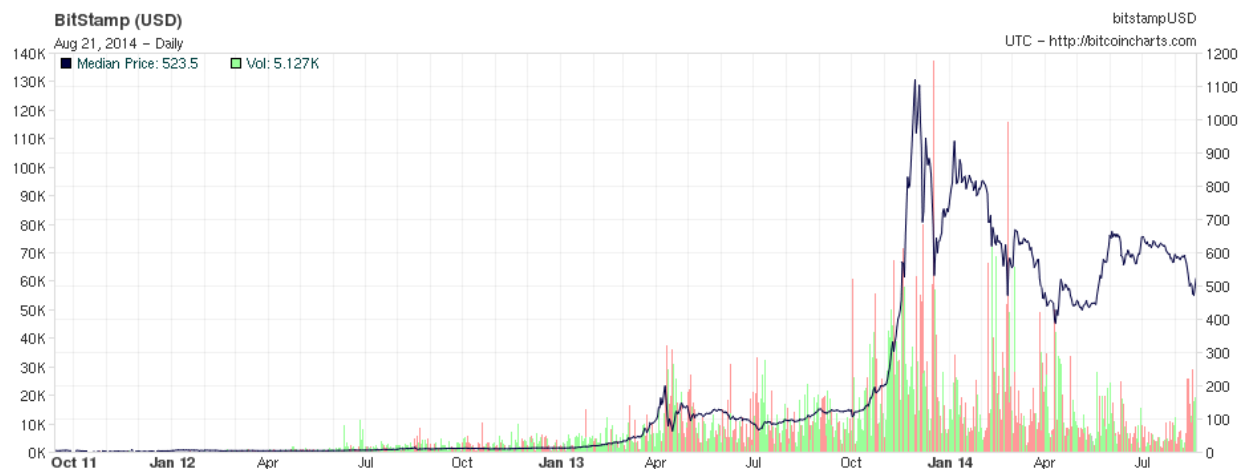
BITCOINS, VIRTUAL MONEY AND THE CHANGING DIMENSIONS OF INDIAN FINANCIAL LAW AND POLICY

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The Bitcoin is an innovative payment network and a new type of money which can be used by individuals and businesses to carry out their financial transactions virtually. As a result of its inherent advantages like freedom to engage in financial transactions ubiquitously, increased level of privacy, very low transaction fees as well as secure mode of working; virtual currencies like Bitcoin have emerged as an attractive currency option for many investors and other stakeholders. In fact, major retailers like Overstock, the online travel booking website Expedia, the computer maker Dell and the satellite television provider Dish Network have started allowing customers to pay using the virtual currency on their websites.

After a spike in its value in 2013 and subsequent volatility of its price, the value of Bitcoin has started stabilizing of late [Refer Figure 1]. However, recurrent controversies and emergence of fads like ‘Gold for Bitcoin’ have raised important legal and policy issues with respect to managing virtual currencies. No wonder, the Reserve Bank of India and the European Banking Authority have already cautioned the users against the risks of virtual currency but have not proposed any regulations. Only the New York State Department of Financial Services has come up with a set of regulations which are also not widely accepted by the Bitcoin community.

Figure 1: The chart shows the median price and volume of Bitcoins



Source: Bitcoin Chart (<http://bitcoincharts.com/charts/bitstampUSD#tgMzm1g10zm2g25zv>)

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Considering that magnitude of virtual economy is already around 8 billion dollars, Indian policymakers should first completely understand the legal and policy issues associated with virtual currencies like Bitcoin before formulating any regulations for managing them.

Legal issues

The usage of virtual currencies raises several legal issues in India

First, it is important to note that virtual currencies like Bitcoin are still not widely accepted as a legal tender. Considering that the value of money is determined by public faith and government backing, it is not feasible to completely rely on Bitcoin as currency. Second, appropriate legal grievance redressal mechanisms for protection of consumers and investors have still not evolved in India exposing users to unwanted financial risks. For example, the shutdown of Mt Gox, a popular bitcoin exchange in Japan on 10th February 2013 supposedly led to its customers losing 548 million dollars. Third, complicated issues pertaining to territorial jurisdiction might arise in case of transnational Bitcoin transactions between users. Finally, considering that the overall oversight of virtual currencies like Bitcoins is still in exploratory stage in India, there is risk that they can be used for nefarious activities like funding crime and terrorism, money laundering, illegal money transfers, tax avoidance etc.

Policy issues

The usage of virtual currency raises some critical regulatory and policy issues as well.

First, the number of Bitcoin is fixed at 21 million .Thus, it is immune to inflation but has a built in deflation mechanism which might encourage hoarding of Bitcoins. In this case, it is similar to gold except for the fact that it has no physical form or underlying asset which further adds to speculation and volatility of its value. Further, the complexity of mining algorithms and inadequate technical expertise might make it difficult for central banks to understand and work with virtual currencies based on mathematical algorithms. This does not augur well for government as Bitcoin transactions might have a substantial impact on monetary policy assuming that there is a persistent trend in growth of volume of Bitcoin transactions.

Second, virtual currency systems like Bitcoin could still contain unexploited technical flaws which cannot always be secured by existing information security practises in India. As this is a fairly new system, if these systems were adopted widely, and a flaw or breach was found, it could give tremendous wealth to the exploiter at the expense of destroying the virtual currency economy in India.

Further, some digital sceptics like David Golumbia who understand virtual currencies like Bitcoin more as a representation of underlying libertarian, free market ideology rather than a mere medium of exchange feel that it is necessary to understand crypto-politics when we design policies to effectively deal with digital currencies like Bitcoin. For example, can we have

confidence and trust in anonymous centres and algorithms to maintain the value of currency instead of our traditional centralized authorities?

The way forward

As policymakers look for a way forward to regulate Bitcoins and other virtual currencies, they have realised that it is too early to design a suitable legal or policy response for managing virtual currencies like Bitcoin. Like every other technology, it must be given some time to evolve before a definitive legal and policy mechanisms are formulated. In this context, a multi-stakeholder forum to discuss these different mechanisms can prove to be a useful starting point to provide some form of policy certainty with respect to managing virtual currencies like Bitcoins in India.

Additionally, it is necessary to inculcate an inter-disciplinary perspective within professionals like lawyers, computer engineers, bankers etc. to effectively contribute to such multi-stakeholder forums and help in creating a win-win situation for all stakeholders. There is need to design suitable courses or training programs for the same. For example, it will be a herculean task for any lawyer to predict and discover new kinds of legal flaws due to usage of virtual currencies like Bitcoins if he is not able to fully comprehend the functionality of an underlying P2P network or hash algorithms. Indeed, government-industry-academia collaborations will have to play a crucial role in developing these inter-disciplinary skill sets. This would certainly reduce genuine opposition to the future regulations related to managing virtual currencies in India unlike the recent opposition to BitLicenses proposal of New York State Department of Financial Services.

In retrospection, one must remember that P2P technologies like Napster eventually forced music industry to embrace online services such as iTunes or Spotify. Irrespective of whether virtual currencies like Bitcoin go bust or not, it is expected to leave a lasting legacy on financial landscape .Hence, it is extremely important that Indian policymakers should convene multi-stakeholder forums to start conceptualising inter-disciplinary policy frameworks for designing better public policy regulations for managing virtual currencies and then work on developing action plans to ensure that they reach their logical conclusion.