

CRYPTOCURRENCY: EVOLUTION & LEGAL DIMENSION

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ABSTRACT

The currency has always been evolving throughout human history. From gold & silver to coins and eventually to paper money. The evolutionary stages of currency include both physical and legal dimensions. With the digital & internet revolution, the evolution of currency was inevitable with Bitcoin being the first cryptocurrency. Presently, more than 2100 cryptocurrencies with over US\$230 billion in market value is evidence of the advancement of the currency in its physical dimension. Nevertheless, the development of the legal dimension of cryptocurrency is either absent or hostile to this idea. The evolution of cryptocurrency shall be complete when its legal dimension evolves as well. This can be achieved by issuing a cryptocurrency that is an official currency. It can be undertaken by individual sovereign states or a group of countries as an economic or political block. Whereas cryptocurrency brings with it a range of advantages from being immune to inflation and inexpensive swift transfers, it does, however, bring with it host of challenges and disadvantages including high volatility, money laundering, frauds, and scams. A cryptocurrency that is issued as an official currency by a sovereign state shall amalgamate most of the advantages while minimizing its disadvantages. Truly, the next step in the evolution of cryptocurrency is to embrace it as a legal tender/official currency.

Keywords: cryptocurrency, official currency, currency evolution, legal dimension, financial innovation

INTRODUCTION

The currency has always been evolving throughout human history. As the exchange of goods and services became more complex the currency evolved accordingly to address these complexities. As the physical dimension of currency changed from gold & silver into metal coins and then eventually to the paper money, its legal dimension changed as well. From being just metal to the official currency with the seal of the ruler or state, thus giving it the legal authenticity.¹ Eventually, with the advent of the central banks, the sovereign states monopolized the issuance of currency.

With the digital & internet revolution, the evolution of currency was inevitable. Bitcoin, the first successful cryptocurrency, was the manifestation of evolution in the physical dimension of the currency.² Currently, more than 2100 cryptocurrencies, with a market capitalization of \$230 billion are in existence.³ However, the evolution of cryptocurrency on the legal side has not kept pace as it has been banned by numerous countries while others are struggling to understand and formulate policies.⁴

The cryptocurrency brings numerous advantages, but a host of problems are holding it back from being adopted by mainstream financial markets. This paper argues that if the cryptocurrency is adopted as an official currency, within the meaning of legal tender,⁵ by countries or an economic bloc,⁶ its advantages will be maximized, and weaknesses minimized. Thus, the true evolutionary phase of the legal dimension of cryptocurrency shall be completed with its adoption as a legal tender/official currency. Nonetheless, cryptocurrency as an additional official currency, not as an alternative, to the existing traditional currency is being advocated.

The paper presents a brief history of the evolution of currency and the environment in which the first cryptocurrency, Bitcoin, was launched. Essential features of currency and its presence or absence in cryptocurrency are discussed. A host of advantages and disadvantages of cryptocurrency in its present state along with the possible solutions are outlined. Finally, the convergence of these ideas that lead to the adoption of cryptocurrency as a legal tender is examined.

HISTORY OF CURRENCY

The first form of currency was precious metals like gold and silver. Later, its physical dimension changed into coins as they were adopted as a medium of exchange by the independent states. These coins were stamped with images and seals of the rulers to give them authenticity and legal status.⁷ As commerce became complex, a novel idea of paper money was imported from China⁸ and once again the physical state of the currency changed. On the legal dimension, it was adopted, printed and given legal status in the medieval Islamic world and later in the European states.⁹

¹Thornton, Mike. *History of Money: From Barter to Bitcoin*, 2nd ed. Kindle Edition (Amazon Digital Services, 2016) location 154.

² Nahorniak, Iryna; Leonova, Kristina; Skorokhod, Vladyslava, "Cryptocurrency in the Context of Development of Digital Single Market in European Union" (2016) 3 *InterEULawEast: J. Int'l & Eur. L., Econ. & Market Integrations* 109.

³ Millán, Luis. "The cryptic world of crypto-currency regulations" *Canadian Lawyer* (4 February 2019)

⁴ *Supra* note 1 at 1270

⁵ Legal tender is defined in Merriam-Webster dictionary as money legally valid for the payment of debts and that must be accepted for the purpose when offered. For the purpose of this paper, it will mean legal currency issued by a sovereign state.

⁶ Economic bloc herein means a group of countries forming an economic or political union e.g. E.U., OIC, APEC, OPEC, etc.

⁷ *Supra* note 1 at 154

⁸ *ibid*, at 170

⁹ Siegfried, Nikolaus A. "Concepts of Paper Money in Islamic Legal Thought" (2001) 16 *Arab L.Q.*, 322

Paper currency brought with it a host of problems, inflation being a major one. Since the supply and issuance of money were monopolized by the sovereign states, throughout its history, several instances of financial system failure led to the economic crisis. In 2008, with the backdrop of one such financial crisis coupled with the growing trade complexities of the internet came the cryptocurrency. Bitcoin, the first cryptocurrency was launched by an unknown person named Satoshi Nakamoto in 2009.¹⁰ This pseudonymous person advocated a decentralized currency with a finite currency of 21 million tokens in total.¹¹ Ten years onwards with hundreds of cryptocurrencies and turnover of over \$15 billion per annum the innovative idea of cryptocurrency is a reality.¹²

CRYPTOCURRENCY: ADVANTAGES AND DISADVANTAGES

Cryptocurrency has many advantages but in the context of this paper following four are most important;

- The launch of Bitcoin with a finite number of tokens resolved the issue of inflation because the currency was not infinite as the case is for the traditional currency.¹³
- Cryptocurrency is mostly a peer-to-peer transaction¹⁴ with no intermediary resulting in huge savings by avoiding bank/institutional transfer fees.
- The transactions are fast, almost instantaneous, with 24/7 availability.
- Blockchain, the technology behind the cryptocurrency promptly addresses the issue of double spending and duplication of digital currency making it secure.¹⁵

The major disadvantages are;

- The volatility (high fluctuations in value) for the cryptocurrency is a significant issue.¹⁶ Since it is not a legal tender, there is no sovereign guarantee¹⁷ resulting in the speculative based value.
- It is vulnerable to hacking and if the tokens of a cryptocurrency are lost, it is almost impossible to recover them due to the anonymous method of transaction.
- Scams, frauds, and deficiency of regulations have resulted in a lack of consumer confidence.
- Money laundering and illegal uses are a major concern for regulators.

FEATURES OF THE CURRENCY

Currency serves three main functions:¹⁸

Medium of Exchange

As a medium of exchange, currencies are widely accepted in exchange for goods and services. Although the cryptocurrencies are gaining traction, the reality is that its use as a medium of exchange remains low.¹⁹ Paper currencies remain an acceptable medium of exchange by virtue of it being a legal tender. If the cryptocurrency is issued by a sovereign state as a legal tender/official currency it will address the issue of its intrinsic value and volatility, thus making it a more conducive medium of exchange.

Unit of Account

As the unit of account, the consumer must be able to numerically compare the prices in the unit of currency. Cryptocurrency is difficult to use as a unit of account because of high fluctuation in its value.²⁰ As an official legal tender with stable intrinsic value coupled with negligible funds transfer cost, cryptocurrency can become the preferred unit of account in the future.

Store of Value

The owner of a currency expects to store the currency and use it in the future while the currency retains its economic value. Traditional currencies are stored in banks and more recently cryptocurrencies can be stored in the digital wallets. Although cryptocurrency is immune to inflation, unlike paper money, due to its volatility it is not a preferred store of value, at present. However, as a legal tender, cryptocurrency will have less volatility. A currency that is inflation resistant and is backed by a sovereign state guarantee can make cryptocurrency a good store of value.

¹⁰ *Supra* note 2 at 108

¹¹ *ibid.*, at 108

¹² *Supra* note 3

¹³ *Virtual Currencies and Beyond: Initial Considerations*, (January 2016), SDN/16/03, IMF Staff Discussion, 15.

¹⁴ Edge, Kathryn Reed. "History of Money: From Cows to Bitcoin" (2014) 50 *Tenn. B.J.* 26.

¹⁵ *Supra* note 13 at 15

¹⁶ *Supra* note 13 at 17

¹⁷ government central bank is the lender of last resort for official currency

¹⁸ *Supra* note 13 at 14

¹⁹ *Ibid.* at 14

²⁰ *Supra* note 13 at 17

CONCERNS AND WAY FORWARD

There are concerns for cryptocurrency being used for criminal activities like terrorism financing and money laundering.²¹ Any innovation can be used for criminal activity. Indeed, it is not the innovation that is good or bad but its use makes it so. An answer to illegal use of cryptocurrency is not a ban but to “*devise means for protecting society from abuses*”²² just as is being done for traditional paper money.

Tax evasion is another such concern. Since cryptocurrency transactions and possession is largely anonymous, it is considered by regulators as a tax evasion tool.²³ However, Blockchain, the technology behind cryptocurrency is an excellent tool for smart contracts and distributed ledger technology.²⁴ In fact, a synergized use of cryptocurrency with smart contracts can make the tax collection process far more efficient than the current system of collection from traditional currency. This is likely to be achieved if cryptocurrency is a legal tender/official currency. Thus, making tax collection more effective and efficient.

Financial institutions are hesitant in adopting cryptocurrency as it would mean a major disruption in their traditional business practices.²⁵ However, if cryptocurrency is issued by a state or an economic bloc this hesitation will be minimized. Further, the roles of banks and financial intermediaries will be re-defined. The financial intermediaries will become custodians of shared distributed ledger of the blockchain for official cryptocurrencies instead of high transfer fee charging entities of traditional currency, as they presently are.²⁶ Hence, these entities will still earn but ultimately the consumers will save immensely due to an efficient system.

In 2018, the annual remittance by the workforce in developed countries to their ancestral developing countries is estimated at around \$528 billion.²⁷ Presently, World bank estimates around 7.7% in the transfer fees for traditional currency as opposed to 1% by cryptocurrency.²⁸ This is an estimated cost saving of \$40 billion for the people from the most deserving parts of the world who rely heavily on these remittances. This can be achieved if a developed country or an economic bloc takes the lead and issues an official cryptocurrency.

CONCLUSION

Once again, the currency is changing its physical dimension into a new state but its legal dimension lags behind in this evolutionary process. Cryptocurrency is a natural evolution of currency in the internet era. It is fast, efficient and a secure medium of exchange with huge cost saving benefits. A currency backed by a sovereign state with finite issuance shall address the long-standing problem of inflation as well. The current weaknesses of cryptocurrencies, including tax evasion, scams, laundering and most importantly its volatility can be minimized by making it a legal tender/official currency. It is an idea whose time has come and the response should be to embrace the innovation rather than suppressing it.²⁹ Hence, cryptocurrency as an official currency, issued by a sovereign state or an economic bloc, will maximize its utilization benefits and shall be a step forward in its legal evolution.

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²¹ State-Sponsored Cryptocurrency: Adapting the best of Bitcoin's Innovation to the Payments Ecosystem. (Deloitte Development LLC, 2015) (Google) 1.

²² *Supra* note 14 at 26

²³ *Supra* note 13 at 6

²⁴ *ibid.* at 23

²⁵ *Supra* note 22 at 5

²⁶ *ibid.* at 3

²⁷ “India to retain top position in remittances with \$80 billion: World Bank” *The Economic Times [of India]*, (Dec 08, 2018)

²⁸ *Supra* note 13 at 22

²⁹ *Supra* note 13 at 35