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CRYPTOCURRENCY

JUNE 2021 | THEME 354

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Cryptocurrency

June 2021| Theme 354

“Price is what you pay; value is what you get.”

Warren Buffet

The “SIB Students’ Economic forum” is designed to kindle interest in the minds of younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is “Cryptocurrency”.

What is a cryptocurrency?

A cryptocurrency is a digital or virtual currency that is secured by cryptography, which makes it nearly impossible to counterfeit or double-spend. Many cryptocurrencies are decentralized networks based on blockchain technology—a distributed ledger enforced by a disparate network of computers. A defining feature of cryptocurrencies is that they are generally not issued by any central authority, rendering them theoretically immune to government interference or manipulation.

History and Background

Bitcoin is widely regarded as the first modern cryptocurrency — the first publicly used means of exchange to combine decentralized control, user anonymity, record-keeping via a blockchain, and built-in scarcity.It was first outlined in a 2008 white paper published by Satoshi Nakamoto, a pseudonymous person or group.In early 2009, Nakamoto released Bitcoin to the public, and a group of enthusiastic supporters began exchanging and mining the currency.

By late 2010, the first of what would eventually be dozens of similar cryptocurrencies — including popular alternatives like Litecoin — began appearing. The first public Bitcoin exchanges appeared around this time as well.In late 2012, WordPress became the first major merchant to accept payment in Bitcoin. Others, including online electronics retailer Newegg.com, Expedia, Microsoft, and Tesla followed. Countless merchants now view the world’s most popular cryptocurrency as a legitimate payment method.

Although few cryptocurrencies other than Bitcoin are widely accepted for merchant payments, increasingly active exchanges allow holders to exchange them for Bitcoin or fiat currencies — providing critical liquidity and flexibility. Since the late 2010s, big business and institutional investors have closely watched what they call the “crypto space” too.Today, there are thousands of alternate cryptocurrencies with various functions and specifications. Some of these are clones or forks of Bitcoin, while others are new currencies that were built from scratch. Some of the competing cryptocurrencies spawned by Bitcoin’s success, known as "altcoins," include Litecoin, Peercoin, and Namecoin, as well as Ethereum, Cardano, and EOS. Today, the aggregate value of all the cryptocurrencies in existence is around $1.5 trillion—Bitcoin currently represents more than 60% of the total value. As of March 2021, there were over 18.6 million bitcoins in circulation with a total market cap of around $927 billion.

NAME	PRICE	24H %	7D %	MARKET CAP	VOLUME(24H)
Bitcoin BTC	$38,746.91	3.34%	4.81%	$724,879,144,385	$40,092,074,954 1
Ethereum ETH	$2,417.69	4.16%	6.16%	$280,893,915,595	$24,312,765,631
Tether USDT	$1.00	0.03%	0.00%	$62,587,606,353	$61,410,509,207
Binance Coin BNB	$353.88	1.96%	4.27%	$54,295,365,204	$1,604,497,698
Cardano ADA	$1.52	1.36%	5.36%	$48,452,579,734	$2,127,395,778
Dogecoin DOGE	$0.31	1.33%	8.00%	$40,571,602,444	$1,350,172,553
XRP	$0.86	0.40%	4.63%	$39,659,957,849	$3,033,404,393
USD Coin USDC	$1.00	0.05%	0.07%	$23,952,339,235	$2,124,233,805
Polkadot DOT	$23.40	1.96%	2.09%	$22,296,504,933	$1,693,404,688
Uniswap UNI	$22.37	3.37%	9.79%	$12,866,118,587	$344,885,051

Data: prices of 10 largest cryptocurrencies (data from https://coinmarketcap.com) as of 7:38 am on 17.06.21

Pros and Cons of Cryptocurrency

Pros of Cryptocurrency

The technology behind cryptocurrency is complicated and often a bit of a black box for those who are not experts. Each coin has its own blockchain, its own rules, and any other technology or other developments they have tied to it. It can be hard to keep up.

1. Cryptocurrency Networks Are Inherently Secure

The focus of most conversations about the security of cryptocurrencies is the underlying technology for mining and exchanging the assets.

2. Mining Is Accessible to Anyone

There is no barrier to stop you from getting involved. With a few Internet searches, you can set up your computer to start mining coins for you.

3. Price Fluctuations Can Create Huge Profits

The value of a coin is determined based on how rare it is, the effort expended mining them, and the characteristics of a particular coin.

4. Cryptocurrency Behaves Like "Real" Currency

Treating cryptocurrency trading as though it were a currency in terms of your investment approach may prove to be the most useful analogy. Many forex strategies can be effectively ported over to cryptocurrency trading.

5. Cryptocurrency Is a Potential Hedge Against Inflation

Because cryptocurrencies generally have finite supply (limited numbers of coins) built into their source code, they are a natural hedge against inflation. Without the ability to print more coins, economic theory suggests over time the value of anything finite should keep up with rates of inflation. Cash in your savings account will often effectively lose value over time because rising costs mean the dollars saved today will be able to buy you less in the future.

6. Crypto Transactions Are Generally Cheaper Than Traditional Electronic Financial Transactions

The concepts of blockchains, private keys, and wallets effectively solve the double-spending problem, ensuring that new cryptocurrencies are not abused by tech-savvy crooks capable of duplicating digital money. Cryptocurrencies' security features also eliminate the need for a third-party payment processor — such as Visa or PayPal — to authenticate and verify every electronic financial transaction.

7. Cryptocurrency Can Reduce the Cost of International Transactions

Cryptocurrencies do not treat international transactions any differently than domestic transactions. Transactions are either free or come with a nominal transaction fee, no matter where the sender and recipient are located.

Cons of Cryptocurrency

Any time you invest money, you are putting it at risk. Bitcoin trading is in many ways like trading a currency or a stock. You are trying to buy at a lower price than you eventually sell at. Stocks have intrinsic value and dividends that they can give you, and U.S. dollars and other major currencies are backed by central banks. But there are not the same tethers for cryptocurrencies.

1. Cryptocurrencies Are Extremely Volatile

Cryptocurrencies are volatile. It is hard to explain how volatile they are. As an example, businessman and entrepreneur Elon Musk mentioning reservations about Dogecoin, after initially voicing his support to the currency, threatened as much as a 70% change in price. Most of this discussion that sent Dogecoin prices on a roller coaster took place on Twitter in a series of tweets over the course of a week.

2. Cryptocurrency Scams Abound

Even the most legitimate seeming company in the cryptocurrency space is more volatile and at risk than those in other industries. And there are still many who hope to scam the unwary.

3. Cryptocurrency Is Less Liquid Than Fiat Currency or the Stock Market

Even the best cryptocurrency exchanges do not hold a candle to the liquidity that is tied to any stock market.

4. The Regulatory Environment Is Constantly in Flux

An area that needs to be watched is the changing laws around cryptocurrencies. In previous years, cryptocurrencies have been taxed at a relatively generous rate and governments have been largely hands-off. New regulations may require reporting from either individuals or exchanges or even by the creators of certain coins. This may drastically change the market. Any market change can make or break fortunes in an evening.

5. Cryptocurrency Wallets and Exchanges May Have Security Flaws

The weak point in cryptocurrency's security is with the user. Although the Bitcoin network itself remains unhacked, several the surrounding software tools that interact with the network have been infiltrated and misused.

6. There's No Recourse for Digital Asset Recovery

There are tens of thousands of dollars of real money locked in computers because the owners do not know how to recover them. Maybe they forgot a key password, or maybe they forgot that they have a couple of Bitcoin they once bought as a joke.

7. Mining Coins Requires Serious Resources

Making serious money from mining requires a commitment of time and money. You will need to prepare a serious set of hardware, with many creating specialized computers or servers for the task. The energy-intensive nature of cryptocurrency mining is problematic for another reason: It's very bad for the environment.

8. Crypto and Blockchain Are Fertile Ground for Hucksters

Blockchain technology is relatively new and hard to understand. As a result, it is often marketed as a modern-day snake oil that can cure all ills. Some fraudsters have argued that their new technology based on the blockchain will replace credit cards or reshape an industry, only for them to disappear with investors' money.

9. Cryptocurrency Has High Potential for Tax Evasion in Some Jurisdictions

Because cryptocurrencies are not regulated by national governments and usually exist outside their direct control, they naturally attract tax evaders. Many small employers pay employees in Bitcoin and other cryptocurrencies to avoid liability for payroll taxes and help their workers avoid income tax liability, while online sellers often accept cryptocurrencies to avoid sales and income tax liability.

10. Lack of Regulation Facilitates Black Market Activity

Probably the biggest regulatory concern around cryptocurrency is its ability to facilitate illicit activity. Many grey and black-market online transactions are denominated in Bitcoin and other cryptocurrencies. Cryptocurrencies are also increasingly popular tools for money laundering — funnelling illicitly obtained money through a "clean" intermediary to conceal its source.

India&Cryptocurrency Bill

The cryptocurrency market in India has developed in a largely laissez-faire regulatory space since the first recorded cryptocurrency transaction in 2010. Between 2013 and 2018, the government's response to the rise of virtual currencies was cautionary, alerting users to the potential risks posed by cryptocurrency transactions. These fears were legitimate and stemmed from cryptocurrencies' volatility, their susceptibility to hacking, and the fact that they could potentially facilitate criminal activities such as money laundering, terrorist financing and tax evasion. Instead of developing a regulatory framework to address these issues, the Reserve Bank of India (RBI), in April 2018, effectively imposed a ban on cryptocurrency trading. This ban was overturned by the Supreme Court in 2020. The court reasoned that there were alternative regulatory measures short of an outright ban through which the RBI could have achieved its objective of curbing the risks associated with cryptocurrency trading. While the court had an opportunity to put a label on the legal nature of cryptocurrencies, it stopped short of doing so.

After swinging between the extremes of non-interference and prohibition, a clue as to India's next move lies in the draft

Cryptocurrency and Regulation of Official Digital Currency Bill, 2021. The draft Bill proposes to criminalise all private cryptocurrencies while also laying down the regulatory framework for an RBI-backed digital currency. The Minister of State for Finance, in response to a question in Parliament, stated that regulatory bodies do not have a legal framework to directly regulate private cryptocurrencies owing to their imprecise legal nature in India. As the draft Bill is yet to be tabled in Parliament, there is some hope that his concerns will be addressed in the form of a tailored regulatory approach rather than another ban.

Final Word

Cryptocurrency is an exciting concept with the power to fundamentally alter global finance for the better.But while it is based on sound, democratic principles, cryptocurrency remains a technological and practical work in progress. For the foreseeable future, nation-states' near-monopoly on currency production and monetary policy appears secure.In the meantime, cryptocurrency users (and nonusers intrigued by cryptocurrency's promise) need to remain ever mindful of the concept's practical limitations.

Any claims that a particular cryptocurrency confers total anonymity or immunity from legal accountability are worthy of deep scepticism, as are claims that individual cryptocurrencies represent fool proof investment opportunities or inflation hedges.After all, gold is often touted as the ultimate inflation hedge, yet it is still subject to wild volatility — more so than many developed countries' fiat currencies.Investing in cryptocurrencies can help to pad your bank account, but realizing high gains requires work. To outcompete everyone else trying to buy low and sell high, you need something on your side.

Your best bet is to apply the same fundamental principles and process you would with any other investment: knowing your own risk, understanding the pros and cons, and trying to make your own determination about whether and to what extent to participate in the market.

Source:

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