

International Monetary Fund

*Reducing Risks Arising
from the Development
of Cryptocurrencies*

Director: Chika Tameda

Moderator: Alejandra Victoria



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INTRODUCTION

Created in 1945 The International Monetary Fund “is an organization of 189 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world” (“About the IMF”, n.d.). Which primary purpose is to guarantee that countries have a stable system of exchange rates allowing them, countries and citizens, to trade and transact with each other

Moreover new technologies have finally catch up to monetary systems, transforming them and creating new ones. Currently, some people and countries have started using Cryptocurrency. Cryptocurrency is a form of digital currency in which the protection and security of such relies on cryptography, which is the process of converting information in a form of uncrackable piece for tracking and transferring (Telegraph Reporters, 2018). Cryptocurrency is not controlled or regulated by any bank, government or centralized financial authorities (“What is Cryptocurrency”, 2018). Its popularity has led to the creation of approximately 856 cryptocurrencies, per instance Bitcoin and Ethereum.

As the use of the cryptocurrency increases so does its popularity, making the risks of this digital currency become more evident. Some alarming risks of this are extreme volatility and bubble risk, which refers to an increase in price of an asset that an individual, corporation or country owns or controls that is not justified by the fundamental supply and demand factors for it (Cornely, 2013) .

Thanks to the lack of protection or back-up of a bank to support cryptocurrencies one could expect to lose a large amount, or even all of the money invested. These virtual currencies, VC, are not regulated by any government and even with the new EU anti-money laundering requirements the VC's still remain unregulated hence these will enter into force later in 2018 and which will become applicable to wallet providers and VCs exchange platforms.. Thus meaning buying or holdin VCs, will not benefit one from the guarantees and safeguards associated with regulated financial services.

Moreover cryptocurrencies have a lack of exit options. Meaning that if one decide to buy VCs, one is at risk of not being able to trade VCs or to exchange them for traditional currencies, such as the Euro, for a long period of time. Likewise there is lack of transparency of where the money comes from or the uses of it. It has been known cryptocurrency has been used for laundering, tax evasion and dodging international sanction hence it is not easy to track (“Regulating the no”..., 2018).

Therein there is misleading information seducing buyers with no expertise, hence the information made available to consumers wishing to buy VCs is in most cases incomplete. Finally some VC exchanges have suffered severe operational problems, such as trading disruptions. During these disruptions, consumers have been unable to buy and sell VCs at the moment they intended to and have suffered losses due to the price fluctuation of VCs held during the period of disruption.

Nonetheless there are several benefits of cryptocurrencies which sometimes seem to outweigh the disadvantages of these. For instance its use makes it easier to transfer funds between two parties in a transaction; these transactions are facilitated through the use of public and private keys for security purposes. The low processing fees in these fund transfers allow users to avoid the steep fees charged by most banks for internet online based transactions. Several buyers think these new currencies are a step forward to preserve value, facilitates exchange, and as something outside the influence of central banks and governments.

Thus despite that the transfer from paper money to cryptocurrencies will not be happening in a short period of time, this issue should be closely and deeply analyzed. Thanks to cryptocurrency trade could be facilitated, as well as cost reduction in products. Yet in order to achieve this countries should reunite and discuss the regulation of it and address the possible risks these might bring. Yet the possibility of a new way to transfer ownership value should not be discarded (Bunjaku, Gjorgieva-Trajkovska, MitevaKacarski, ... 2018).

HISTORY OF THE PROBLEM

Cryptocurrency is a never seen before development for worldwide economies, which would not have been possible without the creation of new technologies. Therein it has not been a long time since the creation of cryptocurrencies. The first cryptocurrency, which is also the most popular among people, is Bitcoin. Satoshi Nakamoto designed Bitcoin back in 2008. In its begin the currency had a value of cents, and it was not until 2009 when the value reach 27 dollars each. In the last year it was estimated that the currency had a value around 7,500 USD.

Nakamoto when creating this currency aimed to solve a problem, double spending. Which is an economic act that allows a currency owner to stop spending the same money twice, thus to solve this Nakamoto decided to make a digital

currency that did not depend on a central authority to have power over the regulation and control of the the currency. ("The History of", 2018).

Soon after this the popularity of this new type of economy began expanding, thanks to the idea of decentralized and encrypted currencies. Thus leading to the creation of new cryptocurrencies, such as Namecoin and Litecoin. Yet there are also altcoins which are, generally, an improvement of the original Bitcoin which offers anonymity, greater speed and other benefits. Which eventually would result in what the world has now a days, 1,000 cryptocurrencies in circulation with new ones frequently appearing.

5 years ago the Bitcoin, for the first time, prize reached \$1,000 dollars, yet this will not last since its prize would soon began to decline. Thus investors of the currency suffered major losses since it drop to \$300 dollars. Making this currency have a suffer a severe bump in it's purchase and investment. Which would not return to its 1,000 prize until 2015.

However another major suffer for cryptocurrencies was in January 2014, when the Mt.Gox, world's largest Bitcoin exchange, went offline. Leaving the owners of 850,000 Bitcoins to go broke hence they never saw him again. Investigations are still on going to discover what truly happened yet versions of the story are still bizarre. Yet all hypothesis point towards that someone viciously and in a deceitful way manage to get control of a haul which at the time was valued at \$450 million dollars. Now a days those lost coins would be priced in around \$4.4 billion dollars

The mentioned before cryptocurrency Ethereum became popular in the eyes of consumer, making it close to stealing Bitcoins success back in 2016. The major characteristic of Ethereum is that it's platform, known as Etherm makes easier to blockchain-based smart contracts and apps. Which will come also with the creation Initial Coin Offerings (ICOs). Offering investors the opportunity to trade stocks of shares through this fundraising platforms in the same manner that they can invest and trade cryptocurrencies. Yet this caught the eye of several governments such as the United Stated, which through the SEC warned investors that due to the lack of oversight ICOs could easily be scams or ponzi schemes disguised as legitimate investments. The Chinese government went one further, by banning them outright. (Marr, 2017).

CURRENT SITUATION

Cryptocurrency as stated before is a new kind of economy that is revolutionizing governments all over the world. Different to other types of currency, this one disassociates from banks thus the decentralized money cannot control the supply for the currencies nor the printing of the units of money. Moreover users of the currencies are the ones who control the value of it by their acts likewise the protocols defined by computers and specialized experts help to control it hence there is no central identity to supervise it. Yet these protocols also hide the true identity of the currency users, leading for people to use these to launder money, evade taxes and dodging international sanctions ("Regulating the no", 2018). Furthermore governments such as the United States have been struggling to stop the misuse of these, since the transformation of money from the physical to the digital world is unstoppable. On the other hand many other countries have been showing their support to new types of economy by shifting from cash to digital currencies.

In the last years there has been an immense increase in the creation of new currencies, as of in the last two years there were around 1, 172 kinds of cryptocurrencies available all over the Internet, however there are still growing. An example of these would be the Digital Dinars, these were created and highly used in Muslim countries back on January 24, 2018. The main difference of this crypto-money is that it is actually backed up by a bank. Which has raised a very important concern, which is that the U.S dollar's supremacy could be affected by this new type of economy. Hence if one considers that 8 out of 14 countries in the Organization of the Petroleum Exporting Countries (OPEC) are Muslims there is always that raising threat that OPEC leaders may be tempted to replace the US dollar in pricing the oil (referred to as petro-dollar) with the more modern, gold-backed, digital alternatives like the Dinars (Favis-Villafuerte, 2017).

As the use of cryptocurrency and the number of users increase there was an estimation made in June 2017 in which shows that the total market capitalization of cryptocurrencies is bigger than 100 billion US dollars (Favis-Villafuerte, 2017). This data proves that cryptocurrency use and inversion has been increasing to the point of having a large value. As previously stated, there is a vast amount of different cryptocurrencies and there are more in development, some of the top ten cryptocurrencies as of January 13, 2017 are: Bitcoin, Ethereum, Ripple, Litecoin, Monero, Ethereum Classic, Dash, Augur, Maid Safe Coin, and NEM (Favis-Villafuerte, 2017). However, as many different types of cryptocurrencies are

developed each legal status of cryptocurrencies are different from one country to another. In some countries, the legal status of cryptocurrencies is still undefined; while in other countries it is changing. Other countries have banned or restricted the use of cryptocurrencies while other countries have allowed the use and trade of cryptocurrencies. There are countries that allow the operations of cryptocurrency exchanges but they have to be duly registered with the government (Favis-Villafuerte, 2017). As the world develops into a much more technology dependant place, forms such as cryptocurrency will become available to a more general audience.

Additionally, the expansion of cryptocurrency in illegal activities such as drugs, hacks and thefts, illegal pornography, even murder-for-hire has increased and has become one of the main reasons of why this currency is spent. Approximately one-quarter of all users (25%) and close to one-half of bitcoin transactions (44%) are associated with illegal activity (Foley, 2018). To further give detail, the main illegal activity done with this currency is the buying of drugs. The total market for illegal drugs in the US and Europe is estimated to be around \$100 billion and €24 billion annually. (Foley, 2018). This proves that Cryptocurrencies advantage of anonymity also facilitates the purchase of drugs and other illicit products overall.

UN ACTIONS

Cryptocurrency is a recent creation and it is still growing between the population. Due to cryptocurrency being a more current and recent topic, there aren't many actions taken by the UN. Despite from this, sub organizations from the UN such as the United Nations Office on Drugs and Crime and the International Monetary Fund has acknowledge the problems involving cryptocurrency and therefore has given several conferences and workshops to give guidance to governments in several aspects such as social development and economic. With this the United Nations looks forward to maintain the people in touch with this new types of technologies and the risks they might bring.

As previously stated, the United Nations Office on Drugs and Crime, UNODC, has been deeply interested in this topic hence cryptocurrencies have become a new way to move criminal procedures. Thus it has created a Cryptocurrency Investigation Train-the-Trainers with partnerships with the actors from RegTech and FinTech, leaders on technology as well as cryptocurrency industry leaders to assist law

enforcement officers and analysts to trace illegal financial flows (“UNODC launches training...”, 2017). Michael Gronager, CEO of Chainalysis Inc, said: "We partnered with UNODC on creating the comprehensive train-the-trainers program on analysis, tracing and investigation of cryptocurrencies. It is a highly important topic: the use of Virtual Currencies is steadily growing and today analysts, law enforcers and prosecutors need training to collect and disseminate data gathered by exchanges and brokers thus supporting the expertise of national agencies in preventing misuse of this innovative technology for criminal purposes."

The head of the UNODC Global Programme on Cybercrime, Neil Walsh, especially thanked the economical support from the governments of United Kingdom, United States of America and Norway among others. Moreover the International Monetary Fund calls all delegations to cooperate with each other to reach a mutual consent in order to regulate and supervise cryptocurrencies. Christine Lagarde, head of International Monetary Fund, stated “An important initial step will be to reach a consensus within the global regulatory community on the role crypto-assets should play. Because crypto-assets know no boundaries, international cooperation will be essential” (McQuaid, 2018). However on the other hand other United Nations branches have different opinions regarding the use of crypto money, like is the case of the UN Research Institute for Social Development which believes the positive outcomes of this outweighs the bad ones. Hence it has stated that Blockchain & Bitcoin may be a possible currency for remittances creating potential for local merchants in poorer countries to participate in international commerce (“Usage of Blockchain...”, 2017).

POSSIBLE SOLUTIONS

As the use of cryptocurrency increases, the variety of its branches grows as well and the use of it normalizes the risks that are brought within. However the benefits from this new type of technology allows smaller and entrepreneur businesses to compete in a free market even with big renown companies, hence helping a country’s economic situation. With these new growing businesses the governments could provide a solution to lack of jobs or participation from the population in a country’s gross domestic product. Nonetheless big and small businesses, government and citizens are exposed to great issues when accepting to use cryptomoney as their currency. It can be either due to the lack of knowledge

regarding the use of cryptomoney, the sudden changes regarding its value or not having a central operator who can transfer digital currencies to actual money.

Therefore reducing those risks are the main interest of this committee, as well as considering any type of benefit that cryptocurrencies may offer. Nonetheless the committee will pay careful attention to problems such as the volatility of cryptocurrencies and the illegal manners which they been used for. In order to reduce the current and future risks that may affect the stability of any given delegation , this committee proposes the following:

1. Urges a deeper research and improvement of information about cryptocurrency available for the general audience so they can be better informed before buying any kind of cryptocurrency.
 - a. Through the cooperation between governments, banks, investors and creators of cryptocurrencies.
 - b. In assistance with specialized technology experts who can guide the delegation in the process of understanding risks, volatility, blockchains, and more.
 - c. Finalized with a campaign which offers all type of information in a simplified manner. This way all types of public can understand cryptocurrencies in order to let citizens and business know the benefits and stakes they might be exposed to when accepting this type of new currency.
2. Requests an improvement of the tracking systems in order to have a rapid process of finding out transfer frauds and stealing of cryptocurrencies.
 - a. Starting from having an identity and username in any type of cryptocurrencies. Hence for many, such as bitcoin the buyer does not have to reveal their identity to do any sort of transaction or investment.
 - b. With this one can assure that if any user commits any crime the individual will be held responsible.
 - c. In guidance with technologies experts develop a faster, and safer tracking system that may assure that most of the features the cryptocurrencies stay.
 - d. In case, the creation of an international center to supervise criminal acts and decide the measure that will be taken depending on the crime. Which may work hand with hand with the solution number 3.

3. Encourages the creation of a special unit committed to supervise that cryptocurrencies are not used in illegal ways nor for tax evasion.
4. The development of a system to regulate for cryptocurrencies values do not be volatile.

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