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Towards a sui generis cryptomoney regulation system for India

By A. Damodaran| Dec 3, 2021

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Renowned Austrian School economist and historian, Ludwig von Mises, once famously said, “Progress is precisely that which rules and regulations did not foresee.” This observation explains the dilemma faced by countries that have attempted to rein in the rapidly progressing world of cryptocurrencies run on blockchain technologies.

Three years ago, in these columns, I had underlined the urgency of addressing the dark web activities connected with cryptomoney (‘Coopting the misunderstood – India’s Cryptocoin Moment’ – *Forbes India*, Dec 19). However, I was not (and am still not) for a blanket ban on crypto money in India, given its tremendous potential to solve some of the pressing problems faced by our rural and urban poor**.

In the preceding thirty-six months since I wrote my article, the blockchain revolution has attained new peaks—with Ethereum Blockchains leading the path. DeFI or decentralised financial products, that owe their origins to the famed Ethereum platform, have managed to garner astounding amounts of investments even during pandemic times. Equally impressive has been the emergence of new genres of smart contract blockchains (like Solana) that have given up on the energy-intensive, climate unfriendly, ’proof of work’ protocols of Ethereum Blockchains. This, in turn, has triggered the launch of Ethereum 2.0, which promises to be sustainable, scalable, and capable of supporting a variety of unusually programmed smart contracts.

Some of the new-gen smart contracts have re-calibrated the mix between automation and human interventions in interesting ways (NFTs being a case in point). These developments would have been unthinkable without ICOs and crypto-tokens. Tokenisation has indeed been one of the most stellar contributions of second-generation blockchains.e first major effect of these rapid changes in the blockchain space is that it has the potential to dump the era of centralised financial institutions and top-down public governance systems. The second major effect of the revolution is the window of opportunity it opens to ‘commoners’ to access public goods.

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In the annals of world history, tokens are considered a dubious piece of work—designed by Emperors and Kings to undermine the solidity of commodity money.

However, tokens generated atop blockchains fall under a different category. They are digitised and anchored in smart contracts that tie contracting parties to ‘performance contingent’ settlement systems. They facilitate granulated ownership over high value tangible or digital assets, thus enabling people with limited means to co-own these resources.

The great lesson that India has learnt in the aftermath of Covid-19 is our weakness in not improving the quality of local health and livelihoods services in city wards and at gram panchayat levels. Tokenisation can overcome this weakness. Indeed blockchain-based digital utility tokens can be helpful in insulating Jan Dhan beneficiaries from inflation. Such utility tokens can provide a major fillip to India’s Jal Jeevan and Swachh Bharat schemes by providing efficient access rights. These are applications that the current cycle of developments in the blockchain space have failed to address.

For realising these objectives, India's widening talent pool of blockchain developers and validators must be supported and incentivised to set up novel ventures that seek to enhance the supply of local-level public goods and modernise the country's industrial and financial sectors.

We have thus a compelling rationale to craft our sui generis system of cryptocurrency regulations. The following measures could perhaps form the elements of our crypto money regulatory framework:

1. Categorise crypto-digital tokens that provide access to public services as 'crypto assets' and list them as 'means of payment other than legal tender' under India's Payment and Settlement Systems Act 2007. This is what Japan has done. This measure would ensure the circulation of localised, narrowly fungible utility tokens that could improve the efficiencies of pro-poor schemes in city wards and village panchayats.

2. Given the sensitivities associated with privately issued 'stablecoins' to INR, it may not be prudent to bring these tokens within the ambit of India's Payment and Settlement Systems Act.

3. Given that India's proposed CBDC project aims to digitise currency segments associated with coins and paper money, the idea of using private cryptocurrencies for micropayment transactions may not be pursued. (This happens to be China's approach as well).

4. While some of the greatest innovations in the blockchain space (like Ethereum) have been driven by ICOs, it is also a fact that many ICOs have duped gullible investors. We could follow the US approach hereby declaring ICOs as securities under the SCRA. This move could promote ICO issues by India based ventures besides enabling investor protection.

5. Being non-fungible and unique, NFTs cannot be categorised either as conventional crypto-assets or as regular security assets that generate ownership rights and regular income streams for holders. However, NFTs could be treated as capital assets that have the potential to generate capital gains through secondary sales.

6. If blockchain-based enterprises are to flourish in India, entrepreneurs need to be provided with the incentive of earning crypto coins. This calls for the existence of properly capitalised crypto trading exchanges that facilitate KYC-enabled trade in security tokens and 'cryptocoins' earned in India. (Here, I am presuming here that the sunset clauses of our proposed crypto regulations would sterilise past holdings of crypto coins and tokens).

7. Finally, India should restrict, if not ban, 'proof of work' blockchains that are energy-intensive and unsustainable and have in place policies that promote climate-friendly, smart contract blockchain platforms. We need to develop a network of cost-efficient blockchain and 'Blockchain as Service enterprises' in India in the coming years.

(The term 'cryptomoney used here is more inclusive as it comprises of both cryptocurrency and cryptomoney substitutes)

A. Damodaran, Professor, Economics and Social Sciences, IIM Bangalore.

Views expressed are personal. The author can be reached at damodaran@iimb.ac.in