THE BLOCKCHAIN BUTTERFLY EFFECT

Contributed by Mr Kamal Gaur (PGP 2004)

As we speak, the IIMA Public Policy Alumni Special Interest Group (PP ASIG) is in the midst of conducting a webinar series on cryptocurrency. The team has been meeting key stakeholders to better understand the crypto space so as to come up with a public policy vision for crypto in India.

It's an interesting problem to tackle because of a few unique elements that are associated with the crypto space. Firstly, the entire industry is less than 13 years old - Satoshi Nakamoto's seminal white paper on Bitcoin & blockchain was released on 31st Oct 2008, in the backdrop of the global financial crisis. In as much time, the crypto industry has mushroomed from 1 cryptocurrency to well over 11,000 cryptocurrencies at last count. From a market capitalization point of view, cryptocurrencies have gone from being near worthless to a combined market cap that crossed $2.5 trillion in May 2021. And in this time, cryptocurrencies have captured the imagination of hundreds of millions of people around the world (estimated at 3.9% or ~300 mn).

Along the way, people have adopted cryptocurrencies for a multitude of reasons - for many, it was the first digital-born native currency that worked seamlessly across borders in a fraction of the time it took traditional currencies to traverse the world. For others, it was the ability to control your own money outside of the confines of the traditional financial ecosystem. For yet others, it was the fact that cryptocurrencies like Bitcoin were coded into existence with a fixed supply, one which no central bank could dilute through quantitative easing. And for yet others, it was the fact that you could move money publicly, yet anonymously, at the click of a button from anywhere in the world. And finally, for many millennials and digital natives, it was the fact that cryptocurrencies felt infinitely better than the real thing – readily portable and infinitesimally divisible – completely invisible in the real world, and with a minimal fear of offline confiscation.

In the initial days, crypto was adopted only by those who were curious enough to participate in a new experiment - it was funny money, if at all it was even that. As time went by, the anonymity it offered helped it become a payment of choice for the dark web as its participants wanted the portability that digital money offered without the traceability that traditional digital money came with. However, as more law enforcement agencies started using customized tools to analyse the public ledger that underpins blockchain, transactions became far more traceable, and following money laundering trails became a lot easier.

If you take a step back and look at the macro view, crypto initially captured the imagination of tech-savvy early adopters, who realized that the adoption they had begun to see was creating wealth unlike they could have imagined. This realization helped capture the attention of financially-savvy early adopters, who began to see cryptocurrency as one of the best, if not the best, investment opportunity of the last 15 years. And slowly but surely, bit by bit, crypto adoption has spread out in multiple directions since then. We are nowhere close to mass adoption even now, but if history is any indicator, it will happen like all mass adoption does – slowly but surely at first, and then all of a sudden.

We’ve seen a couple of watershed moments in the last few years though – one was back in the summer of 2017, when Bitcoin prices had finally come to a head and blown past the $1500 mark. If you hadn't heard of crypto, chances are you wouldn't have heard of the 2017 bull run. But in case crypto was on your radar, you’d have been hard pressed to miss the palpable excitement in the air. During the 2017 bull run, Bitcoin peaked at $20K, and then dropped precipitously, almost overnight. In hindsight, it was likely the introduction of bitcoin futures back in Dec 2017-Jan 2018 that allowed skepticism to enter the markets and temper the excitability of the crypto space.

2017 was also the time of the ICO (Initial Coin Offering) boom, when people realized they could use the crypto space as a global peer-to-peer crowdfunding marketplace, that could be accessed by anyone without having to jump through regulations that are needed to access regulated capital markets anywhere in the world. The interesting part was that almost all funds raised through ICOs were raised using cryptocurrency (Ether to be precise) through the bull run, so when the markets turned, it did in the ICOs too. When the dust settled, billions of dollars' worth of crypto raised by thousands of projects were worth but a fraction of what they were worth at the time of fundraising. As a result, many good projects never managed to see the light of day due to the sudden drop in the value of funds raised, which had a knock-on effect on startup runways. Needless to say, the ICO phase saw a bunch of scams too, where projects went online with nothing more than a flashy website and an obscure white paper, and walked away with crowdfunded ether worth millions of dollars. Still, the ICO boom of 2017, and the following bust, helped the crypto space consolidate around better projects as fly-by-night ones faded away into oblivion.

It's been 4 years since 2017, and the flavour of the 2020-21 crypto bull run has been Decentralized Finance and NFTs (Non-Fungible Tokens). Decentralized Finance is exactly what it sounds like – the ability for peer-to-peer participation in financial arrangements (like lending, investments, insurance) without the need for a centralized entity (like a bank) that holds your funds. The DeFi space has grown 100x in terms of Total Value Locked (TVL) over the past 18 months – from less than $1 billion in April 2020 to a shade under $100 billion in September 2021. However, unlike the DeFi space which is largely looking to replicate the traditional financial ecosystem without a centralized third-party, the NFT space is looking to create and cross new frontiers all on its own. NFTs are about ownership of digital assets, which are publicly visible and accessible, but yet scarce and unique, and hence, non-fungible in that sense. NFTs look to introduce the concept of scarcity in a digital world where the cost of replication has always been zero-to-none – and it is likely going to have far-reaching impact on areas that go beyond just digital art or collectibles. NFTs have the potential to evolve towards capturing anything unique that will benefit from being tokenized in a transparent and public manner, including real estate and other real-world assets.

As we can see by now, it is widely believed that blockchain technology that underpins cryptocurrency will have far-reaching impact on not only the financial ecosystem, but also reinvent the world in other domains. It is now also felt that the cryptocurrency space has become too big to ignore, and is not going to go away anytime soon. There is also a growing demand for positive and clear regulations for crypto from multiple quarters. For one, there is an ever-increasing base of retail investors from almost every country around the world who expect their governments will not exclude them from participating in a once-in-a-lifetime global wealth creation opportunity. As 2020 has shown, there are institutional investors like Microstrategy, Square and Tesla that are buying Bitcoin on their books – and as of 2021, most global banks are well on their way to finding ways to enable their high-net-worth investors with exposure to the crypto markets. 2021 has also seen El Salvador take the first step ever taken by a country to adopt Bitcoin as 'legal tender' alongside their existing currency of the US Dollar.

Closer home, India finds itself at an interesting point in her journey… she has a growing population, which will help her overtake China as the world's most populous nation before the turn of this decade. She has a young population, with an average age of less than 30 years. She has the largest growing middle class anywhere in the world, and also the world's largest English-speaking population.

India's Reserve Bank is not a fan of cryptocurrencies, and it has made that amply clear by trying to stamp them out back in 2018, when it released a circular that banned its member banks from servicing cryptocurrency exchanges, effectively cutting off any fresh supply of fiat funds into or out of the Indian crypto markets. Less than 2 years later, the Supreme Court of India ruled that the RBI circular was unconstitutional, effectively overturning it. This also coincided with a global downturn in financial markets due to COVID-19 lockdowns around the world, which then led to a bullish recovery that has lasted the better part of the last 18 months. Along with traditional equity markets, cryptocurrencies have also been on a tear, with their combined market cap growing more than 15x between the trough of March 2020 and the peak of May 2021, a mere 15 months later.

Seeing the potential of cryptocurrencies to create generational wealth, and how blockchain promises to be a technology underpinning many important solutions the future world will need, it is important that India come up with a public policy that enables the best parts of crypto to thrive, whilst regulating the riskier parts of crypto so as to protect the most vulnerable parts of society.

As this entire ecosystem unfolds before our eyes, the IIM Ahmedabad Public Policy ASIG has been keen to form an educated opinion around the cryptocurrency space in India. They graciously extended the invite to me, an avid participant in the blockchain & cryptocurrency space, to help navigate this space. So far, we've had conversations with various stakeholders – a legal expert who was involved in the Supreme Court case between the cryptocurrency exchanges and the RBI, an industry participant who is the founder of an Indian cryptocurrency exchange, and a public policy expert who chaired the inter-ministerial committee that looked at cryptocurrency regulation recommendations back in 2019.

As we move forward, we plan to speak to stakeholders like crypto entrepreneurs and experts international financial regulations and taxation, as the PP ASIG looks to round up this webinar series and come out with a set of public policy recommendations.

For more insights on how the webinar series is coming along, feel free to follow our conversations at https://bit.ly/3C3wsrD. As the webinar series draws to a close, the IIMA PP ASIG will be publishing a set of public policy recommendations at https://www.iima.ac.in/jsw-spp/.