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The United States allows Bitcoin trading in its stock markets: A Milestone in Cryptocurrency Integration into Traditional Finance

The US has allowed investments in bitcoins through its stock exchanges. This signifies Cryptocurrency's integration into Traditional Finance and brings them at par with stocks and bonds.

On January 10, 2024, the United States Securities and Exchange Commission (SEC) approved 11 applications for spot Bitcoin Exchange-Traded Funds (ETFs). The approved ETFs include big financial firms like BlackRock, Fidelity, and Invesco, as well as cryptocurrency firms like Grayscale and Bitwise.

Many of the ETFs may begin trading on U.S. exchanges like Nasdaq, NYSE and the CBOE from January 12th. Both the institutional and retail investors can now buy Bitcoin shares through these channels like they invest in shares, bonds and gold.

With this, the US takes a pivotal step towards integrating cryptocurrencies into its conventional financial system. High trading in crypto will increase demand for the US$, and this may be a dominant factor behind the US decision.

This decision will influence other countries including India to reassess their regulatory stance on cryptocurrencies. The powerful crypto lobby will now push for swift adoption of crypto currencies and policy harmonisation across the globe.

What are Spot Bitcoin ETFs?

An ETF is an easy way to invest in assets without having to directly buy the assets themselves. Spot Bitcoin ETFs are investment funds traded on stock exchanges, similar to traditional ETFs, but exclusively focused on Bitcoin.

Unlike Bitcoin futures ETFs that bet on the future prices of the cryptocurrency, spot Bitcoin ETFs are tied to the current market price, or "spot" price, of Bitcoin. These ETFs are physically backed, meaning they hold actual Bitcoin in cold storage, which correlates with the ETF shares owned by the investors. This allows investors to gain exposure to Bitcoin's price movements without the complexities of buying, storing, and securing the cryptocurrency themselves.

Bitcoin prices began to rise since October 2023 in anticipation of Bitcoin ETFs

The crypto market, including Bitcoin, experienced a period of decline and turmoil. However, Bitcoin's price has started to recover since October 2023. This recovery saw Bitcoin's value surge from a low of $16,000 in November 2022 to $46,500 after the announcement of Bitcoin ETFs. The anticipation of Bitcoin ETFs has been a key factor in this price recovery.

Concerns about Increased Risk and Volatility

The high trading volume in Bitcoin ETFs may lead to a further increase in Bitcoin's price. Some analysts predict that this could push Bitcoin's price as high as $100,000.
Allowing free trading of Bitcoin through stock markets could spread its volatility to the entire stock market. The unpredictable price changes of Bitcoin could affect a larger number of investors, including those who might not be fully aware of or prepared for the inherent risks of cryptocurrency investments.

Cryptocurrencies: Basics

Cryptocurrencies are digital or virtual currencies secured by cryptography, making them nearly impossible to counterfeit or double-spend. They operate on decentralized networks powered by blockchain technology, a distributed ledger recording all transactions. Unlike traditional currencies managed by central banks, cryptocurrencies are not issued or controlled by any single entity.

Most cryptocurrencies are created through a process called mining, where computers solve complex mathematical puzzles to validate transactions and earn new coins as a reward. However, some (like stablecoins) are issued by private companies and backed by physical assets.

Cryptocurrencies offer several advantages, including decentralization, which ensures no single entity controls the network, enhancing security and reducing manipulation. Their use of cryptography and blockchain technology makes them highly secure and difficult to hack. Additionally, their transparency is evident as all transactions are publicly recorded on the blockchain. They facilitate faster and cheaper cross-border payments than traditional banking systems and provide financial inclusion for those with internet access but without traditional banking services.

However, cryptocurrencies also come with significant pitfalls. Their value can be extremely volatile, making them riskier investments. The regulatory landscape for cryptocurrencies is still developing, leading to uncertainty and potential risks, including government intervention. As an emerging technology, blockchain is susceptible to technical glitches and security vulnerabilities. The process of mining some cryptocurrencies is energy-intensive, raising environmental concerns. Lastly, the anonymity of cryptocurrencies can be exploited for illicit activities like money laundering or financing criminal organizations.

India’s policy

Cryptocurrencies are not recognized as legal tender in India, restricting their use in everyday transactions. While there's no dedicated regulation, several steps have been taken to manage the sector: In 2018, the Reserve Bank of India (RBI) banned banks from providing services related to virtual currencies, thus limiting institutional involvement. In 2022, a 30% tax on gains from cryptocurrencies and a 1% tax on transactions were introduced. Since March 2023, crypto assets fall under anti-money laundering regulations, demanding stricter compliance from exchanges and service providers.

The proposed "Cryptocurrency and Regulation of Official Digital Currency Bill" of 2021, still under review, suggests banning all private cryptocurrencies like Bitcoin and Ethereum, barring exceptions for blockchain technology, and introducing a Central Bank Digital Currency issued by the RBI.

Despite these uncertainties, a crypto market exists in India through peer-to-peer trading and offshore exchanges. However, investors face risks due to lack of legal safeguards.

India’s possible future approach

In the light of crypto’s acceptances in regular financial system in the US, it remains to be seen how India’s crypto policy evolves in coming months. With the new US action, with ramifications on global capital flows, price of gold, foreign trade, it may not be possible to live with no regulation.

India may consider adopting regulatory sandbox approaches, allowing for controlled testing of innovative crypto-related products and services. It may need to balance innovation with risk management and adapt advancements in blockchain technology. Any approach must factor the core issue that the anonymity of cryptocurrencies can be exploited for illicit activities like money laundering or financing criminal organizations. The US regulation so far does not deal with this core issue.

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GTRI aims to create high-quality and jargon-free outputs for governments and industry on issues related to trade, technology and investment from the perspective of development and poverty reduction.

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Feedback

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