AUSTRALIAN INSTITUTE *of* BUSINESS

The New (?) Elephant In The Room: Cryptocurrencies

19 April 2021

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While most readers of AIB Review would be familiar with bitcoins and other forms of cryptocurrencies, in-depth knowledge of their prevalence is less common. This article explains some of the features of this brave new world, and why it needs to be taken seriously in all areas of life and work.

Looking Backward

May 22 is the 'Bitcoin Pizza Day'. This is so thanks to Laszlo Hanyecz who paid 10,000 Bitcoins to purchase two pizzas on 22 May 2010. Ten years later, as of 25 February 2021, the same 10,000 Bitcoins are worth a staggering A$645 million. It does also mean that Satoshi Nakamoto, the pseudonym who created Bitcoin and believed to have set aside one million coins for herself, is currently sitting on A$74 billion. The rest, as they say, is history.

Taking Stock

Cryptocurrencies are digital tokens that drive and facilitate a decentralised, global online payment system. In contrast to national currencies, cryptocurrencies are not legal tender, have no intrinsic value, are not widely accepted currently, and have no sovereign or central regulators underwriting their sustenance. They are simply worth what participants feel about them, and consequently, are willing to pay for them in the exchange.

Unsurprisingly, cryptocurrencies are riddled with uncertainties and risks. On 22 February 2021, Janet Yellen, the newly appointed US Treasury Secretary professed the 'policy view' that cryptocurrencies was an "extremely inefficient way of conducting transactions". The official bitcoin website itself recognises the risk of losing digital funds due to damaged or loss of stored hardware, due to bitcoin-stealing malware, spyware and viruses, delisted/removed digital wallets, and 51% attacks.

For example, Mt. Gox, the Japanese exchange which then handled 70% of bitcoin transactions, filed for bankruptcy in 2014 after it was hacked and 850,000 bitcoins were stolen. The loot was worth approximately A$65 billion as of 25 February 2021. Furthermore, value of cryptocurrencies and initial coin offerings (ICOs) does exhibit price fluctuations driven by sudden changes in perceptions, 'pump and dump' schemes, and importantly, due to no underlying rational reasons. For example, the bitcoin value which grew by 305% in 2020 alone had a 17% drop within minutes following a single tweet by Elon Musk in February 2021 ironically causing him to lose A$19 billion in the process. Chris Larsen who co-founded Ripple, had his investment value in the same currency decline from A$105 billion in 2018 to approximately A$10 billion by February 2021.

Furthermore, cryptocurrencies are characterised by inherent difficulties in estimating their intrinsic values (because they are not assets that generate cashflows), high transaction fees (currently hovering around US$30 per transaction), and long processing times (approximately 10 minutes per transaction). Bitcoin and other cryptocurrencies also face numerous challenges from governments who want to retain control over money supply and monetary policy, regulate illegal activity including money laundering, and prevent 'bubbles' that can undermine overall systemic and economic stability.

Notwithstanding these certain uncertainties, As of 25 February 2021, Bitcoin, the primary face of cryptocurrencies, has a market capitalisation of A$1.2 trillion. This places Bitcoin in the same league as Apple, Microsoft, Alphabet (umbrella of Google), and Amazon and above and beyond Saudi Aramco and PetroChina. Even the Dogecoin, which started as 'a joke' in late December 2013, has a current market capitalisation of A$10 billion making it more valuable than Xerox and Western Union. Then, there is the 'commercial wisdom' of a growing list of high-profile corporates such as Microsoft, Coca Cola, PayPal, AT&T, Virgin Galactic, Norwegian Air, KFC, Subway, Burger King, and Pizza Hut who accept bitcoin as payment. Apart from announcing it will accept bitcoin as payment in the near future like MasterCard and BNY Mellon, Tesla has taken a step further and invested $A1.9 billion of their corporate cash in bitcoin in January 2021. Just six weeks later, as of 23 February 2021, this investment in bitcoin has accumulated an unrealised profit in excess of $A1.2 billion on Tesla's books.

Looking Forward

Even the most sophisticated financial conglomerates consider the blockchain technology to be the next seismic shift in the world of financial infrastructure after cloud computing and internet. For example, Citigroup acknowledges the possibility of Bitcoin surpassing the US dollar as the primary trade currency primarily due to its unrestricted global reach and regulatory neutrality. These claims are further strengthened by crypto exchanges such as Gemini, Krakan, and Genesis Capital who offer interest on cryptocurrency balances signifying their appeal as a store of value and payment option.

In line with the changing financial landscape, government authorities have gradually begun acknowledging the obvious presence of cryptocurrencies and their associated realities. For example, Taxation Determination – TD 2014/25 issued in 2014 by the Australian Taxation Office (ATO) specifies that cryptocurrencies are not money but are just capital gains tax assets. However, more recent legislation changes acknowledge that "digital currency is a method of payment and the consequences of using it as payment are the same as the consequences of using money as payment".

Consequently, taxation rules have evolved to accommodate cryptocurrency as a means to pay for goods and services, as a means to receiving value, Goods and Services Tax (GST) implications, and initial coin offerings (ICOs). In fact, ATO is currently enhancing its data matching program protocol (DMPP) to envelop transactions from cryptocurrency designated service providers (DSP's) such as trading, mining, and exchange entities. These measures are expected to improve ATO's access to the cryptocurrency transactions, investments, and trading gains and losses pertaining to Australian taxpayers. Even the corporate regulator, Australian Prudential Regulation Authority (APRA), has indicated that it has no intentions to curtail retail investment products linked to cryptocurrencies. This announcement has come in the backdrop of Cosmos taking steps to list its Bitcoin exchange traded fund (ETF) on the Australian Stock Exchange (ASX).

Thus, there is no surprise that the Reserve Bank of Australia (RBA) itself is planning to mint its own digital currency based on the distributed ledger platform technology underpinning Ethereum. The conception is to create 'stablecoins, a form of 'digital currencies backed by a fiat currency, like the one being set up by Facebook, known as Diem, that will allow money to be transferred seamlessly across the internet'. Other countries such as China, Thailand, and United Arab Emirates (UAE) are also strengthening their capabilities in developing government sponsored digital currencies initially for cross-border wholesale transactions. These developments at the government level have received the backing of corporate giants such as Deloitte which emphasise the need to reduce transaction costs, reduce processing errors, achieve higher processing speeds, balance privacy with anonymity, and do so with revolutionary technology and without excessive regulatory oversight.

Such is the enormity of the new elephant in the room. In fact, in many rooms, be it policy, regulation, economy, finance, and even the living room!

Note: Library of Congress database provides a comparative summary of legal and policy landscape surrounding cryptocurrencies around the world. It covers 130 countries and several regional entities.

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