

THE BENEFITS AND DRAWBACKS OF DIGITAL CURRENCIES, AS WELL AS COUNTRY EXPERIENCES

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Abstract

The phenomenon of trading in virtual currency (Bitcoin) has recently become active in the world, and it is considered illegal because there is no obligation on any central bank or government in the world to exchange its value for money issued by these governments, global traded goods, or in exchange for Gold, and dealing in it is fraught with benefits and high risks. Currently, the decision is that the volatility of the digital currency's value, along with the scarcity of investor and consumer protection, makes it risky to rely on it as a payment instrument and to maintain a stable value or unit of account. Without a doubt, in-depth studies and research in this area will aid in comprehending this new technology, defining its implications on numerous policies, and demonstrating the hazards associated with it.

Keywords: Digital Currencies, Bitcoin, Financial Stability, Financial Action Task Force, Cryptocurrencies.

INTRODUCTION

The concept of digital currencies initially emerged in 2008, ten years ago, when the global financial crisis sparked study and the development of novel systems and solutions to improve the worldwide economic situation. These decentralized currencies began to flourish, expand, and thrive considerably during the time. However, the idea originated with Satoshi Nakamoto, a programmer who presented a research paper on the concept of a new monetary system for electronic payment in which digital virtual currencies are dealt with without the need for a financial institution or the supervision of monetary and international authorities, as well as the mechanism by which the transaction will take place.

The phenomenon of trading in virtual currency (Bitcoin) has recently become active in the world, and it is considered illegal because there is no obligation on any central bank or government in the world to exchange its value for money issued by these governments, global traded goods, or in exchange for Gold, and dealing in it is fraught with benefits and high risks (FSB, 2015).

Price volatility is a common feature of digital currency trading, and it has a negative economic impact that may jeopardize financial stability. The digital currency (BTC) reached its highest market value at the end of 2017, then lost more than 80% of that value in 2018, although it fared better than the other digital cryptocurrencies, which lost at least 90% of their value. Figure (7-1) depicts this. Figure (7-2) depicts the market value of the most well-known digital currencies in 2018, ordered in order of appearance priority.

Following the creation of Bitcoin, additional currencies entered the market, the majority of which are based on the Bitcoin premise and are clones of it, while some have their own system. LiteCoin and Namecoin were launched in 2011, followed by PeerCoin in 2012, Novacoin and Ripple in 2013, Dash (BCH) in 2014, Ethereum in 2015, and others (CBJ, 2023).

Arab and foreign country experiences

Governments and central banks in Arab and foreign nations treated central digital currencies differently due to variances in their aims, policies, and fund structure. The motivations of central banks in launching digital currencies varied according to each country's distinct circumstances.

In general, the world's countries may be split into categories based on how they respond to this issue, particularly with the growth of electronic payment systems, worldwide economic dealings, and the interconnectivity of international financial markets:

- Because of its advantages in payment systems, certain nations permitted the circulation of this contemporary money technology.
- Other nations have prohibited trade in it in order to preserve their local currency and economy, as well as to address worldwide concerns about electronic piracy, money laundering, and terrorism funding.
- While several governments have performed research and studies on the influence of the circulation of these currencies on different countries' policies as well as financial and monetary stability, no official decision has yet been released.²²

Arab country experiences

According to the Bank of Morocco's February 2019 report, "The Risks and Repercussions of Virtual Currencies on the Financial Sector," many Arab governments have acknowledged that trading in digital currencies is illegal, including Saudi Arabia, Morocco, Lebanon, Egypt, Qatar, and the Emirates. The State of Bahrain has declared virtual currencies to be a commodity that may be traded on stock markets, but it does not consider them legal money.

Foreign countries' experiences

According to a variety of sources, governments' and central banks' reactions to this new invention varied. Some nations have performed study and analysis on the benefits and hazards of digital currencies, as well as their influence on the local currency and financial stability.

According to a recent International Monetary Fund report published in March 2019 that discusses the use of cash across countries and the demand for digital currencies issued by central banks, a number of countries, including Canada, China, Norway, Denmark, Singapore, Sweden, and the United Kingdom, have provided analytical studies and published regulatory frameworks to understand. This currency's mode of operation is an attempt to investigate the economic impact of issuing such digital currencies on the local currency and financial stability.

The Turkish Central Bank's November 2018 Financial Stability Report also mentioned a number of worldwide experiences in this respect, as follows:

- Several central banks, including those in Russia, Estonia, Italy, the Netherlands, Iran, and Malaysia, have said that they are developing digital currencies.
- China: The People's Bank stated that the process of developing digital currency as a future form of money is unavoidable, and that it has expanded its activities through

its research laboratory to prevent this innovation from causing any fundamental or irreparable damage to the economy.

- Ecuador: Its central bank was regarded as the first to launch a sort of account-based CBDC in 2015, when it opened accounts for individuals and enabled transfers using phone applications. However, it was not widely adopted by individuals in all payment operations and was officially canceled in December 2017 due to its failure to be fully compatible with current payment systems, as well as the system for accessing these accounts being difficult to consider as a means of exchange, implying that it cannot be used as a substitute for cash.
- Venezuela: In 2018, the government announced plans to establish a digital currency token backed by the country's precious metal reserves, particularly oil.
- Switzerland: According to the National Bank, Distributed Ledger Technology (DLT) is not a viable or adequate technology to enable CBDC and is no better than traditional payment system infrastructure.
- The European Central Bank stated that there is no urgent need to issue a digital currency at this time, and that demand for money is constantly increasing, so there is no plan to issue a digital currency in the near future, but it is analyzing the potential consequences of issuing such currencies as a complementary part of cash.
- A group of central banks from Canada, England, Japan, and Australia indicated that there is no compelling reason to create digital currencies at this time since, despite their benefits, they may have a detrimental impact on the current currency, banking system, and financial stability.
- Uruguay: The Central Bank recently concluded a trial project using digital currencies issued by the central bank for general purposes, which was part of the government's financial inclusion initiative, which began in 2011. The Central Bank completed a pilot operation in November 2017 to issue, test, and disseminate the e-peso currency. Based on a central platform created by an international corporation in October 2017, these currencies were distributed by a financial institution and retrieved after six months, with a value in the central bank account that was complementary to legal currency. The project was initially successful, however it was terminated in April 2018. The experiment is now being evaluated before a decision on additional trials and eventual release is made.
- Turkey: ING Bank in Turkey recently stated that 18% of Turkish citizens hold cryptocurrencies, and as a result, Turkey decided to establish its own digital currency, known as Turkcoin, that does not contradict Islamic Sharia principles.

Theoretical Framework

Among the most significant advantages of digital currency are:

- **Wide acceptance:** Digital currencies based on distributed ledger technology (DLT) are generally acknowledged as a significant and innovative payment method. Some see it as a way to boost demand for products and services, while others see it as a cutting-edge payment system.
- **Privacy and confidentiality:** Because of the nature of distributed ledger technology (DLT), transactions made through it are completely private; buying and selling

transactions carried out through it cannot be monitored or interfered with, nor are they subject to governmental or banking oversight, nor do they pass through any regulatory body or bank. It also benefits from total transparency of the transfer of value (money) without disclosing the name and information of users or documents linked to the transaction.

- Low fees: Transactions made with digital currency have the advantage of not requiring the trader to pay any additional transportation and transfer costs, such as those typically charged by banks and credit card companies, and thus eliminating the need for a third intermediary to transfer the money.
- Processing speed: Digital currencies based on distributed ledger technology (DLT) may settle and clear transactions at any time and from any location in the globe faster than traditional payment and payment systems.
- Global: Digital currencies based on distributed ledger technology (DLT) are often regarded as an open network. They are not geographically restricted and may be dealt with from anywhere in the world.
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- convenience of use: When compared to traditional payment methods, users of digital currencies benefit from some convenience in terms of the number of steps necessary to complete the payment process.

The following are the most important hazards associated with the use of digital currencies:

- Price volatility: In addition to market and liquidity concerns, long-term risks associated with swings in the values of digital currencies can impose extra difficulties and losses on users.
- Insecurity feature: The confidentiality and encryption of information may make it easier to carry out suspicious and illegal operations such as security breach, piracy, and embezzlement, in addition to the risks of operational operations in which users' ownership information in the DLT ledger may be lost, eroding trust in the digital currency. As a result, the number of users reduced. To minimize such concerns, some users may rely on intermediaries to retain and maintain information pertaining to their possession of digital currency units.
- Prepayment with certainty: The digital currency system lacks dispute resolution tools and provides a particular feature of irreversible payment. This feature may be regarded advantageous for the beneficiary in order to minimize fraud concerns or to ensure that expenses are reimbursed, as opposed to the user, whose conviction for using digital currencies may wane.
- Violating international laws: There has recently been debate about whether digital currencies are a tool for money laundering and terrorist financing, and many international bodies, including the Financial Action Task Force (FATF), have spoken about the risks associated with digital currencies in this regard, including the FATF, which issued a report on how to manage the risks associated with virtual currencies related to money laundering and terrorist financing.

- Tax evasion: Because of the secrecy and camouflage features, it will be difficult for specialized government authorities to collect taxes on digital currency transactions.

Digital currency types

1- Cryptocurrencies

Cryptocurrencies are a sort of digital currency that is based on an encryption technique (Cryptography) and is seen as a valuable asset utilized as a means of exchange. They are decentralized currencies that are not issued by any government or central bank and have no link to legal fiat money. They function using digital ledgers (DLT), which is a decentralized method for recording and verifying transactions. There is also no central authority that supervises all procedures, transactions, and transfers, and Bitcoin is an example of one of these currencies.

2- Central bank digital currencies (CBDC) are digital currencies issued by central banks.

Many central banks across the globe have begun to explore launching their own central digital currency at some time in the future. The ambition of many central banks to stay up with current financial system advances, particularly in light of efforts to transition to cashless (digital) society, is perhaps the most notable cause for this evolution. According to a paper issued by the Bank for International Settlements' Markets Committee (MC) of the Committee on Payments and Market Infrastructure (CPMI) on central bank digital currencies, recent innovations related to payment and payments activities are an important part of central banks; it provides systems that help speed up financial services. As a result, the introduction of a central bank digital currency will symbolize these advancements, with implications for the payments system, monetary policy, and financial stability. The committee described digital currencies issued by the Central Bank in this context as "a new form of central bank digital money that differs from bank balances or their settlement accounts at the central bank."

The requirements and issues associated with the issuing of digital currency by central banks (CBDC).

Before issuing and using central digital currency (CBDC) on a broad scale, central banks and stakeholders must consider a variety of criteria and problems.

- Legislative framework: The issuing of digital currencies by central banks (CBDCs) necessitates legislative changes to the relevant regulations, which may be impractical in the short term. Because central bank-issued digital currencies will employ DLT technology, there will be various users who will make changes to the distributed ledger set, in addition to other associated difficulties such as when mistakes in commitments and unlawful payments will be rectified. The question is whether this digital currency (CBDC) is considered mandatory legal tender, whether it can be considered a tool for fulfilling financial obligations, and whether the laws governing the transfer of currency value and the rules governing the inevitability of payment (prepayment feature) apply.
- Anti-Money Laundering and Terrorist Financing Act of 2009 (AML/CFT) compliance requirements: Central banks (CBDCs) are required to comply with the requirements of the AML/CFT Law, as well as control and tax rules, while issuing digital

currencies. Until yet, it is unclear how these rules would be enforced for CBDC forms, particularly those that cross borders and are utilized in other countries.

- Reputational concerns: When central banks (CBDC) issue digital currencies, they must address reputational risks, particularly those associated with digital currencies released for general CBDC.
- money privacy: Central banks must consider an adequate level of privacy for the digital money that will be issued, which will limit the central bank's overall policy choices.
- Cybersecurity requirements: Before releasing digital money, central banks must take precautions to reduce the dangers of a cyber attack by offering cyber risk mitigation measures. The digital form of cash released for general purposes is the most vulnerable to a large number of network users (attack points), raising the danger of piracy and electronic fraud.
- Solid infrastructure requirements: Before issuing digital currency, central banks must consider the provision of a strong and solid operational infrastructure, especially since the available technologies (DLT) for issuing and managing the CBDC currency are still not approved and the private sector is still in the early stages of developing and applying the technology (DLT) for commercial purposes.

The influence of central bank-issued digital currencies (CBDCs) on financial stability

Central bank-issued digital currencies are regarded as a new kind of money that must be adopted as a modern digital innovation in the financial system.

- Issuing a digital currency for the central bank will not change the basic mechanisms for implementing monetary policy, but if the flows of this currency are large without compensation in the decline of legal banknotes, as is the case in financial crises, then there may be challenges that appear (such as expanding the central bank's asset base or its capacity to take guarantees).
- Issuing this currency increases the central bank's presence in the financial system, which means a larger role for the central bank in distributing economic resources, which leads to total economic losses if the central bank is less operationally efficient in distributing resources than the private sector. • The global characteristic poses challenges to financial stability by introducing political risks to central banks, particularly if the digital currency is issued in the form of a digital currency.
- The rise of institutional cash pools encourages customers to finance long-term assets with short-term obligations, which are associated by the risk of loan renewal or rollover risk, severely impacting financial stability. One way for central banks to mitigate these risks is to supply non-banking organizations with a cash-like asset.

Based on the evidence available to it, the Financial Stability Board (FSB) found that encrypted assets do not represent any possible hazards to global financial stability at this time. As a result, crypto assets lack the features of required legal money and do not serve as a common method of payment, a stable store of value, or a unit of account flows. He stated that as long as these assets spread, they may pose a variety of hazards in the long run, including:

Risks to one's reputation and faith in financial institutions and regulatory agencies.

- The risks of direct and indirect financial institution exposure.
- Risks associated with the use of crypto-assets as a payment method in payment and settlement systems.
- Risks associated with the impact of market size and wealth inflation

CONCLUSION

Despite the good aspects of digital currencies, such as their capacity to satisfy public policy objectives such as financial inclusion, security, consumer protection, and privacy, precautions must be taken to avoid any negative consequences. With the requirement for worldwide legislative coordination and collaboration, as well as rules that govern the issuance of this money and its circulation procedures. Central banks and other relevant parties must continue to study and monitor digital advancements, as well as evaluate their work and how it may influence or be affected by others. This comprises digital currency innovations created by the private sector and not subject to any regulatory authority. Currently, the decision is that the volatility of the digital currency's value, along with the scarcity of investor and consumer protection, makes it risky to rely on it as a payment instrument and to maintain a stable value or unit of account. Without a doubt, in-depth studies and research in this area will aid in comprehending this new technology, defining its implications on numerous policies, and demonstrating the hazards associated with it.

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